(3)

91-877 No. 91-

In The

Supreme Court of the United States

October Term, 1991

ERNST & YOUNG,

Petitioner,

v.

BOB REVES, ET AL.,

Respondents.

Petition For Writ Of Certiorari To The United States Court Of Appeals For The Eighth Circuit

APPENDIX TO PETITION FOR A WRIT OF CERTIORARI

VOLUME II

JOHN MATSON
(*Counsel of Record*)
CARL D. LIGGIO
ELIZABETH B. HEALY
380 Madison Avenue
New York, New York 10017
(212) 773-3910

KATHRYN A. OBERLY
DANIEL M. GRAY
1200 19th Street, N.W.
Washington, D.C. 20036

FRED LOVITCH
4705 Central Avenue
Kansas City, Missouri 64112

Attorneys for Petitioner

COCKLE LAW BRIEF PRINTING CO., (800) 225-6964
OR CALL COLLECT (402) 342-2831

188

TABLE OF CONTENTS

Page

VOLUME I

VOLUME II

TABLE OF CONTENTS – Continued

APPENDIX C

IN THE UNITED STATES DISTRICT COURT
WESTERN DISTRICT OF ARKANSAS
FORT SMITH DIVISION

THOMAS E. ROBERTSON, JR., as Trustee of the Farmer's Co-Op of Arkansas & Oklahoma, Inc.; BOB REVES: FRANCES GRAHAM: ROBERT H. GIBBS, individually; ROBERT H. GIBBS, as natural guardian of his minor children, THOMAS A. GIBBS and ROBERT H. GIBBS, JR.; and ROBERT H. GIBBS, as Trustee of the Muskogee Internal Medicine Group Profit Sharing Funds — PLAINTIFFS

v. — Consolidated Cases No. 85-2044
85-2096
85-2155
85-2259

JACK E. WHITE, ET AL. — DEFENDANTS

MEMORANDUM OPINION

I. INTRODUCTION:

In *Robertson v. White*, 633 F.Supp. 954 (W.D. Ark. 1986) we tested the legal sufficiency of the plaintiffs' consolidated complaint. We tried to make it clear at that time that our purpose was to determine which allegations could sustain a cause of action under the most liberal and indulgent construction. Even so, the court was greatly troubled by certain of the plaintiff's claims. We suggested that some of them may very well have been barred by the statutes of limitations. Instead of dismissing them at that

point, we advised the parties that we would rule on the questions later, in connection with motions for summary judgment. In addition, we expressed reservations about the applicability of certain causes of action to the parties. In this connection, we were doubtful that R.I.C.O. questions could be raised against the work of auditors, based on *dicta* in *Bennett v. Berg* 710 F.2d 1361 (8th Cir. 1983). The passage of time has brought with it two recent Eighth Circuit civil R.I.C.O. decisions which raised for our consideration vexing questions whether any of the defendants had been shown to have operated an enterprise "through a pattern" of racketeering activity. *See, Fulmer v. Superior Oil Co.*, 785 F.2d 252 (8th Cir. 1986) and *Holmberg v. Morrissette,* Civ. 85-5138 (8th Cir., slip. op., Sept. 3, 1986). That the court of appeals for our circuit would overturn two verdicts, the factual findings of which are to be deemed controlling unless "clearly erroneous" FRCP, Rule 52(b), indicates to us that the court to whom we are immediately responsible has developed and is developing a requirement for pattern fundamentally more rigorous than one which it suggested might be appropriate in *Alexander Grant v. Tiffany Industries,* 770 F.2d 717, 718 n.1 (8th Cir., 1985). Those who thirst for consistency in the law can find their solace in the fact that *Alexander Grant* explicitly said that it was not passing on the sufficiency of a showing of pattern in its decision, was judging (as we did) only the sufficiency of a pleading, and, coming a year before *Fulmer* and *Holmberg,* can hardly be said to be the final word on the topic. It may be possible that our system of notice pleading will permit still more R.I.C.O. cases to enter discovery, since "pattern", unlike fraud, may not have to be specifically pleaded. It is

probable, therefore, that cases under a Rule 12 examination will continue to confuse the resolution of motions arising under Rule 56. The sufficiency of the plaintiffs' case is here today subjected to a more rigorous screening than the one which we pursued a half a year ago. In that connection, too, the rules for decision have changed. Whereas formerly the Eighth Circuit enjoined that motions under Rule 56 be denied if even the "slightest doubt" was present, *Traylor v. Black, Sivalls, and Bryson*, 189 F.2d 213 (8th Cir., 1951); now the trial courts are admonished to enter judgment against parties where no reasonable jury could find for them on the best construction of facts submitted in support of their case. *Anderson v. Liberty Lobby, Inc.*, 54 U.S.L.W. 4755 (June 23, 1986). We do not sit as triers of fact, and make no credibility determinations, since under our Constitution, that lies with the province of the jury. U.S. Const., Amendment 7. Rather, we determine whether, for example, the plaintiffs' evidence, *if believed*, suffices to present a factual question subject to resolution by a jury. If not, we enter judgment for the moving party, as we did for plaintiffs on their securities law claims a few months earlier. *Robertson v. White*, 635 F. Supp. 851 (W.D. Ark. 1986).

If it appears to the professional reader that the court is writing far too pedantically, we plead guilty and offer by way of explanation our hope that members of the press, who will read this opinion and broadcast its holdings extensively in the week before trial commences, will take special pains to inform its audience that the court is making no factual findings in this opinion, only deciding whether plaintiffs should be allowed to present all or part of their case to a jury. Parties on all sides of the case have

remarked that an extraordinary amount of press coverage seems to have developed out of this lawsuit. This is understandable in a case involving 23,000 plaintiffs and nearly 40 defendants. Defendant Creekmore is a well-known member of the community, having served as a circuit judge for several counties in this federal division for 20 years. Other of the defendants are professional accountants and lawyers with fine reputations in the community. The court is therefore concerned that persons reading this opinion not "misreport" the court's legal conclusions to the public. The plaintiffs have made a number of allegations against the defendants. This opinion finds that some of them may not be presented to a jury, and that others can be. That is all. The sole aim of this opinion is to determine whether a juror, *if he believed the plaintiffs' evidence and the most reasonably favorable interpretation of it,* could decide the case adversely to defendants. It goes without saying that no juror is *bound* to hold against them because of anything we say or do here. The court is very concerned that the press exercise extreme care in advising the public of the very limited nature of our inquiry, so that no needless prejudice will attend the parties' quest to draw a fair-minded jury from the seven counties in our federal division. We believe that the press has done a good job in this respect, and will continue to do so throughout the remainder of these proceedings. We would feel very uneasy, this close to trial, to release these opinions without appropriate cautions. With this in mind, we will proceed to examine the record on defendants' motions for summary judgment under Rule 56 of the Federal Rules of Civil Procedure.

II. COUNT I: RETURN OF FEES PAID BY THE CO-OP:

Defendants Ball and Mourton, attorneys at law, and the Arthur Young accountants, have moved for summary judgment on the trustee's cause of action under Count I of the Consolidated Complaint, wherein he asks for a return of all moneys spent by the Co-op for the defense of Jack White and Gene Kuykendall in a federal criminal action styled *United States of America v. Jack White and Gene Kuykendall*, CR-80-20028-01, 20028-02, (W.D. Ark., Sept. 5, 1980 – January 23, 1981), *affirmed*, 671 F.2d 1126 (8th Cir. 1982).

The basic facts have previously been set forth in this and court's opinion, *Robertson v. White, et al.*, 633 F. Supp. 954 (W.D. Ark., 1986). The parties have amplified the record for purposes of their motions for summary judgment on this count, and the Court, necessarily, will too. We understand that the test for granting a summary judgment after *Anderson v. Liberty Lobby*, 59 U.S.L.W. 4755 (June 24, 1986) requires the court to examine the record to determine whether a reasonable jury could find in favor of the non-moving party on his claim or defense. Our analysis will therefore be conducted along those lines. This opinion will primarily treat the arguments advanced by Ball and Mourton. The court believes that an extended treatment of their claim provides the easiest *entree* into a discussion of the motion made by Arthur Young and the Creekmore "submission". (Carl Creekmore's July 22, 1986, motion for summary judgment does not specifically address the Court I claim; it will be addressed tangentially in this motion.)

On September 5, 1980, the Grand Jury indicted White and Kuykendall for wilfully subscribing a corporate tax return which they knew to be inaccurate in material respects (2 counts) and for conspiring to violate 26 U.S.C. Sec. 7206 by filing a materially inaccurate return (1 count). The indictment said that Jack White had engaged in a course of self-dealing activity with the Co-op, and had disguised his conduct by submitting a false return. It is true that the indictment did not charge him with self-dealing, *per se*. There is no federal crime of self-dealing. But at the very basic level of wanting to know "what they said he did," a person would be justified in reading the indictment as having alleged that Jack White had been involved in self-dealing with Co-op assets. Indeed, another reading of the indictment would be technically correct, but such a perfection in understanding the indictment is inessential for these purposes, which only seek to determine whether a reasonable person would have suspected or concluded that White's stewardship of the Co-op was under fire. Taking that as our measure, we apprehend that the Grand Jury substantially averred that Jack White operated the Co-op's business on numerous occasions at less than arm's length. This is the conclusion drawn by the court of appeals, *United States v. White*, 671 F.2d 1126, 1128, (8th Cir. 1982) ("the indictment charged that White had engaged in a course of self-dealing"). It would be obviously futile to suggest that a reasonable jury could not find, as a fact, that the indictment put persons on notice of White's history of self-dealing, in the face of the Court of Appeal's characterization of it.

On September 8, 1980, the Co-op met with Ken Mourton, who discussed the indictment with them. Following

questions by the Board, the directors passed a resolution expressing confidence in White, stating that there was "no money missing" from the Co-op. On December 11, 1980, the directors passed a resolution authorizing the Co-op to pay the legal fees and expenses incurred by White and Kuykendall. The petit jury convicted the defendants on all counts on January 23, 1981, after a fourteen day trial. The court of appeals affirmed the judgment on February 26, 1982.

The record would support a reasonable jury's finding that the I.R.S. began an investigation of the Co-op in December, 1976, and in February, 1977, decided that the transactions it had examined merited screening by its criminal investigation division. In May, 1977, Jack White asked the Board for authority to hire tax specialists for the Co-op which, at that time, was itself under civil and criminal tax investigation by the I.R.S. The Co-op authorized White to do this, and on May 16, 1977, the Co-op hired E. J. Ball and Ken Mourton, d/b/a Ball and Mourton to represent it in the on-going investigation covering calendar years 1973, 1974, and 1976. (BMA Statement of Undisputed Facts, Par. 18). The Co-op continued to use the services of Ball and Mourton up until the Co-op filed for bankruptcy in February, 1984. Thereafter, the bankruptcy court retained Ball and Mourton for the estate until October, 1984. *Id.*

A reasonable jury could find that experienced men of affairs, at the highest levels of their professions, would understand the indictment as *alleging* that White had self-dealt with the Co-op; furthermore, on the record, such men would have been able to appreciate the dimensions of the Government's complaint at some earlier time, since

there were numerous meetings with the Government in the pre-indictment stage. An objective review of some of the transactions giving rise to the 34 "overt acts" in the conspiracy count would reveal a pattern of unlawful fiduciary behavior practiced by White, the Co-op's general manager. (Indictment, BMA Exhibit 14, pp. 378-79). For example, in 1974, the City of Van Buren, Arkansas, financed the construction of the modern Co-op complex by issuing $1.5 million in Act 9 bonds. Jack White bought them all. The Co-op loaned White $1.5 million at no interest to buy them, and paid 8% interest to him as a bondholder. White took the interest in lieu of his yearly bonus, as we understand the testimony of the criminal trial, so the deal is not quite as bad as it sounds. However, to this date, no one has suggested a plausible explanation why it was advantageous for the Co-op to structure the transaction in *this way*. Had the Co-op kept its $1.5 million and sold the bonds, or even tried to, it would still have saved "property taxes" and would still have paid the same "low" interest rate [Ball, Affidavit, Para. 11 (e)(i) and (ii)]. By using its own money (presumably demand note proceeds,) the Co-op was borrowing money at 8% from note holders (the rate paid notes from May, 1974, to September, 1976, when it dropped to 7% [Ball, Affidavit, 916(f) p. 9]) in order to loan that same money to White, so that White could indirectly loan that same money back to the Co-op at 8%. The Co-op paid 7% to noteholders from September, 1976, to July 1, 1977; so for a time the Co-op paid White more. In any event, there is one clear winner here: Jack White. It appears from this scenario that the aim and end of this transaction when all the corn has been shucked, was to give Jack White tax-

free income. Certainly, he did not energetically market bonds, and had no incentive to. The corporation would have had an incentive to have the bonds marketed, since that would replenish funds taken from current assets. As the transaction stood, demand note funds were used to purchase long term assets, depleting the current ratio. At the very least, the corporation suffered an adverse effect on its current ratio in order to give White tax-free income.

One question, therefore, bothers the court: if this transaction were *bona fide*, why have all the lawyers and accountants failed to come up with a plausible reason for it? The lawyers and accountants obviously have a motive for advancing such an explanation *if it exists*, since otherwise they run the risk that a reasonable jury may conclude that experienced men of affairs read and understood the indictment in its general signification, and that they furthermore, upon investigation and reflection, could have determined that the allegation that White profited at the expense of the Co-op was probably true. Such a conclusion has serious implications for the resolution of motions under Count I of the complaint. The court does not gainsay that criminal defense counsel have the undoubted right vigorously to contest any adverse characterization of a client's activities or motives by the Government; that, in fact, is their duty, upon the performance of which all our liberties depend. That is not in question. Count I asks the question from whom such an advocate may expect his pay after he is done saying his piece. Can a lawyer reasonably expect a corporation harmed by his client's activities to pay legal fees for defending the client against a criminal indictment which calls into question the very acts which harmed it?

The indictment, in fact, exhibits a pattern of such conduct engaged-in by White and Kuykendall. In another example, in 1974, the Co-op stored surplus fertilizer at a time when Nebraska farmers were facing a shortage. The Co-op through White arranged to sell the product at a premium price. Not all the receipts from the sales were recorded as belonging to the Co-op. Instead $240,000 of the receipts found their way into demand note accounts of fictitious individuals. It is possible for a jury to conclude that this was done, as White and Kuykendall swore, to create a "reserve" for fertilizer which "caked" in the Co-op's storage bins that summer, although the juror would have to wonder why the artifice of the bogus accounts was created for this purpose.

Contrarily, a reasonable juror could conclude that this artifice was intended to benefit White. Soon afterwards, $225,000 was moved back into the Co-op when the bogus noteholders "bought bonds." White's loan account was reduced $225,000. The Co-op paid the bogus noteholders 8% interest on their "bonds." Could not a reasonable jury conclude that the imaginary demand note accounts were created in order to give White access to the funds?

The court believes that on balance a reasonable juror could conclude that this artifice was contrived in order to benefit White, and that a reasonably experienced professional would grasp this almost immediately. The jury which convicted White and Kuykendall may very well have concluded that White's "caked fertilizer" explanation did not hold water. First, the suggestion that defendants created a "reserve" for ruined fertilizer did not surface until long after the investigation commenced.

Second, the weather data did not support the defendants' contentions. The very kindest interpretation one can put on matters is that White and Kuykendall hatched this scheme simply to save the Co-op some taxes, since the sales to the Nebraska farmers were non-patronage-based and therefore fully taxable. Of course, this interpretation ignores the fact that such a goal could have been achieved more simply and expediently, with no devious devices at all, simply by making the Nebraskans members of the co-operative. Alternatively, White and Kuykendall may have wished to avoid making the Co-op pay a "patrongage dividend" to the Nebraskans, which would have had to have been done if they paid $10.00 to become members. The court believes that a reasonable jury may come to a conclusion which is more easily understood in these parts: that the bogus accounts were created so that White could draw on and use the money between July, 1974, and January, 1975. The court has examined the accounting system used by the Co-op for demand notes, and believes that in the case of a fictitious payee, it would be more than possible to, in effect, "keep two sets of books," using the money at will, and to create an essentially bogus paper record of the transactions, because there appears to have been no effective controls which would have prevented that from happening.

The relevance of this discussion to our problem is that the allegations in the September 5th indictment are such that a jury may reasonably conclude that BMA were actually aware that White had pursued a course of action inimical to the Co-op, or at least were on notice of the potential conflict. Nor were these two examples the only ones. The indictment also alleged that White borrowed

$1.2 million from the Co-op at ten percent, only to turn around and loan it to his associates at twelve percent. The court does not intend to enter the *lacunae* of whether this opportunity was truly a corporate opportunity which White misappropriated. The issue is: how can a corporate servant conscientiously pursue his duty to get the most of his master's dollar, when he intends himself to loan that money to a third party and make a profit for himself?

The court believes, in short, that a jury could find that possibly in 1977 when Ball and Mourton first agreed to work for the Co-op, and almost certainly by 1978, when the attorneys were briefed as to the dimensions of the criminal case by the I.R.S., Ball and Mourton were in a position to appreciate the conflicts, real and potential, in representing both White and the Co-op.

Ball and Mourton appear to concede the applicability of *Raines v. Toney*, 228 Ark. 1170, 313 S.W. 2d 802 (1958) to this question. They suggest that *Raines* holds that third parties (presumably, in this case, Ball and Mourton) may be liable to a plaintiff whose fiduciary injured him, only if the third party knowingly assisted the corporate officer in breaching his duty to the plaintiff. The BMA brief questions whether the record supports that (a) White breached a fiduciary duty to the Co-op by accepting indemnification for his legal expenses, and (b) whether BMA knowingly assisted him in doing so. (BMA, Brief, p. 7).

The case at bar is far stronger than *Raines v. Toney, supra*. Here, the third party is itself a corporate fiduciary. Here, the third party received the full benefit of the moneys misappropriated from the Co-op to indemnify

White, contrary to law. The case brought by the Trustee is stronger, by far, than the one brought by the bankruptcy trustee in *Proctor v. Norris,* 188 N.E. 625 (Mass., 1934). In *Procter,* one MacClaskey controlled the bankrupt Phoenix Bond and Mortgage Co., and also owned an interest in a concern called Hodgdon, Cashman & Co., which was in financial straits, to the extent that some of its customers were asserting claims against MacClaskey personally. In December, 1927, MacClaskey went to defendant, a newly licensed lawyer, and told him that he wished to pay Hodgdon-Cashman creditors out of his own pocket in a way that Cashman would be required to repay the lawyer. The attorney, Norris, set up a trust account from which to pay creditors at MacClaskey's direction, and agreed to receive from Cashman notes for the amounts of the checks. MacClaskey told Norris that he wanted Cashman to believe that Norris himself was extending credit to Hodgdon-Cashman, and Norris undertook the task, believing MacClaskey was using his own funds as represented. *Id.*, at 626.

In fact, without authority, MacClaskey drew checks to the lawyer's order out of the Phoenix Bond & Mortgage Co. account, signing them as Treasurer. The court found that Norris, though acting honestly and though ignorant of whether Phoenix Bond was a corporation or not, could easily have discovered the truth. The court determined that the defendant knew that the checks were drawn for a purpose unconnected with the business of Phoenix Bond, and charged the lawyer with notice that MacClaskey (who was president, treasurer, majority shareholder, and [essentially] the total board of directors of Phoenix) was not empowered to draw off corporate

funds in order to pay Cashman's creditors. Pointedly, the court observed that the defendant "though acting honestly and though ignorant as to whether the company was a corporation or not, could easily have discovered the truth," *Id.*, at 626. The court noted that even with innocent purpose, the lawyer knew that the checks were unconnected with the business of the Phoenix Bond and Mortgage Company, and was chargeable with notice that MacClaskey probably had no right to draw them. The defendant was therefore considered by the court to have come into possession of funds belonging to the corporation, and to have assisted MacClaskey in diverting them to an unlawful use. *Id.*

The *Proctor* court deemed it irrelevant that the young lawyer had not received the money for his own benefit. "An agent of fiduciary who receives trust property and disposes of it in a transaction beyond the legal powers of the fiduciary is liable as a constructive trustee to the beneficiary," the court decided. *Id.* As a concluding matter, the court noted pertinently that "the failure of the directors of the . . . company to perform their duties could not give MacClaskey any right to divert corporate funds, or estop the corporation, the stockholders, or the plaintiff to seek their restoration." *Id.*, at 627.

We believe *Proctor v. Norris, supra,* to be a correct statement of the law, and to the extent that the case at bar differs from it, it does so in ways inclining the balance even more favorably to the Trustee. First, in this case Ball and Mourton were Co-op fiduciaries at the point they undertook White's representation and the Co-op's pay; in *Proctor,* the lawyer owed no fiduciary duties to the Phoenix Bond and Mortgage Co. Second, in this case Ball and

Mourton received the misappropriated moneys; in Proctor, the lawyer disbursed it at MacClaskey's instructions. Third, Ball and Mourton were in a superior position to observe and conclude that the fiduciary White had breached his duties to the Co-op, or at the very least had failed to comport himself with "a punctilio of fairness the most honest"; whereas the *Proctor* defendant appears successfully to have been deluded, and at the very least was never shown an indictment to arouse his suspicions. To the extent that there is a difference, it is this: here the Board passed a resolution, there it didn't. The Proctor *report* persuasively suggests that such a resolution would have been a mere formality in that case. There is persuasive evidence in this case that Ball and Mourton considered the board's consent to the arrangement to be no real impediment to the plan: months before the indictment was issued (itself three months before the board passed the December 11 resolution) Ball and Mourton decided that they faced a conflict in representing Kuykendall. Ball then called Hugh Hardin, a Fort Smith lawyer, and asked him if he would represent Kuykendall, telling him that the Co-op would pay the fees for it. Kuykendall was never an officer or employee of the Co-op. He had not even a colorable claim for indemnity under the statutes. For some reason which Ball and Mourton's summary judgment motion does not address, the Co-op's lawyer was evidently confident that the cooperative would pay Kuykendall's fee; so obviously he must have been confident that it would pay his own. The fact that the Co-op board sealed the pact with no real debate hardly suggests that the result in this case should be different as a matter of fact and law than the result in *Proctor*.

That is, simply because directors abdicate their fiduciary responsibilities to shareholders does not excuse the Co-op's lawyers from their duty independently to investigate the propriety of the payment. The indictment was sufficient notice to Ball and Mourton that a conflict existed to enable the court to say that they ran the risk that they might be deemed constructive trustees to the Co-op. This is most especially so in the case where bankruptcy intervenes. The trustee may prosecute a cause of action based on an unlawful diversion of assets or on a statutory liability created by the law of the state of corporation. That an officer's conduct has been ratified by the board does not avail the defendant. *Neese v. Brown*, 405 S.W. 2d 577 (Tenn. 1964), *noted* 35 Tenn. L. Rev. 673 (1968). The trustee loses his rights only where the transaction sued upon has been ratified by all the stockholders. *Field v. Lew*, 184 F. Supp. 23 (E.D.N.Y. 1960); *See also, Cunningham v. Jaffe*, 251 F. Supp. 143 (D.S.C., 1966). These cases evidently take the position that a shareholder "always could" sue derivatively to recover the assets diverted, and because that power existed "in the right of the corporation" e.g. Ark. Stat. Ann. Sec. 64-223 (1980 Repl.), no action by the board of directors can remove the issue from litigation.

The court therefore believes that summary judgment should be denied Ball and Mourton on Count I of the Complaint. On the law, the trustee succeeds to any right which the corporation had. Certainly White had no right to indemnity under the corporations act. Such a claim could only be justified where White acted "in good faith" in engaging in the underlying conduct. Given that this underlying conduct may reasonably be found to have

been "self-dealing," a Co-op shareholder could have sued at any time, derivatively, to require White and other recipients to disgorge the fees. In such a circumstance, a court may ultimately defer to a board of directors' decision, but it is not required to. Certainly if a court concluded that White's 1973-77 activities as listed by the indictment constituted self-dealing, it would be difficult to conclude that he acted in "good faith" and therefore impossible to defer to the directors' decision. A court would have to conclude that White breached a fiduciary duty by accepting benefits contrary to law. CF. *Assoc. Milk Producers v. Pair,* 528 F. Supp. 7 (E.D. Ark. 1980) (semble).

Having made that determination, a jury could conclude that Ball and Mourton took their fee from the Co-op knowing far more than anyone the presence of actual and potential conflicts presented by White's activities from 1973 through 1977. They therefore assisted and profited from White's acquiescence in a benefit to which he was not entitled.

Concerning the defense of limitations, we are persuaded that the three year limitation applies. Ark Stat Ann Sec. 37-206 (Repl. 1982). *Cooley v. First National Bank,* 276 Ark. 387, 635 S.W. 2d 250 (1982). *McGhee v. Glenn,* 244 Ark. 1000, 428 S.W. 2d 258 (1968). (action to recover money paid by mistake barred in three years). Ball and Mourton continued representing White on his criminal indictment on through March, 1982. Presumably, they were paid for this work by the Co-op. They failed to show, therefore, that all of the money received by them was disbursed prior to February 23, 1981, the relevant date for purposes of computing limitations on claims

brought by the trustee. Under a "continuing wrong" theory (among others) any wrongful receipt of moneys pursuant to an initially wrongful breach of fiduciary duties tolls the limitations period. The defendants Ball, Mourton and Adams' motion for summary judgment on Count I is therefore denied.

Arthur Young's motion stands on slightly different footing. First, they did not receive their fees as fiduciaries of the Co-op. They were witnesses hired by Ball and Mourton and owed no duties to the Co-op during the time they were so engaged. Second, Arthur Young did not ever arguably "assist" the breach of White's fiduciary duties. That is, it may be argued that Ball and Mourton, attorneys for the Co-op, "assisted" the breach of the duty by failing to advise the Co-op when they were otherwise under a duty to speak. (This issue was *not* resolved in the Ball and Mourton discussion, and is only included here for purposes of analysis.) Unlike the lawyers, the accountants had no duty to advise the Co-op on the question whether it should pay White's fees and expenses. The Arthur Young defendants are the most passive vessels among the parties sued in Count I. The directors who were sued passed the resolution authorizing the payment; White and Kuykendall directly benefitted and had a duty to disclaim the benefit arising out of their relationship to the enterprise; Creekmore, the Co-op counsel, presented the resolution for approval and did not (at least) counsel against its passage, and thereby assisted the breach by failing to discharge a positive duty he owed, then and there, to his client; finally, as we say, Ball and Mourton failed to correct their client's appropriation of the money, and directly benefitted from that failure. In

no sense can Arthur Young's conduct in this circumstance be likened to any other party's.

In our view that does not matter. Arthur Young has argued that Count I charges asserts "some kind of tort claim" and protests that "it is a mystery what text Count I purports to assert . . . but it is clear that no viable claim is asserted. Count I alleges only that Arthur Young 'knowingly received' money for professional services – a not surprising fact and one that does not normally constitute tortious conduct." (AY Motion to Dismiss, pp. 8-9).

The court believes that a reasonable jury can find the following: (1) that sometime in 1980, Ball and Mourton hired the Russel Brown (now Arthur Young by merger) firm to provide litigation support to it in the criminal trial of Jack White; (2) that the primary parties to the contract of employment were Ball and Mourton as "parties of the first part" and the Russel Brown accountants as parties of the second; (3) that Ball and Mourton told them that they would be paid by the Co-op, but that the parties knew that the employing party, Ball and Mourton, would remain primarily liable; (4) that this conversation predated the Co-op's December 11 resolution authorizing the payment of fees for White and Kuykendall; (5) that Arthur Young thereafter knowingly received fees from the Co-op (as opposed to fees distributed through Ball and Mourton's Trust Account); (6) that Arthur Young was fully aware that there had been alleged that White had improperly benefitted from what accountants refer to as "related transactions" and therefore was aware, or should have been aware, that the receipt of fees was a related transaction within the meaning of that term; and, (7) that Arthur Young, in August 1981, after having received fees

from the Co-op in January, 1981, accepted an engagement to audit the cooperative's statements, one part of which would include passing on the propriety of the payment of White's fees.

Under this analysis, which a reasonable jury could entertain, Arthur Young should have been aware, similarly to the lawyer in *Proctor v. Norris, supra,* that reimbursement for its services ought to have come from Ball and Mourton in the first instance. They accepted the money notwithstanding its source, and notwithstanding the context; *i.e.,* that they were being paid by the Co-op for the benefit of White against whom allegations of self-dealing had been made.

A reasonable jury may conclude that Arthur Young's acceptance of such funds from a party only secondarily liable (if at all) on the contract between them and Ball & Mourton was such as should have alerted them to the questionable propriety of the arrangement. If the payment be questionable in any case, a jury might reasonably conclude that it is highly questionable in a context where the firm provided services to a corporate employee who was substantially charged with self-dealing, particularly where they were in a position to learn the full details of those transactions (notably the Act 9 bond transaction,) the *bona fides* of which they are to this day unable to explain (or have chosen not to at this time.)

A reasonable jury may conclude that the Arthur Young defendants became corporate fiduciaries (within the scope of their employment) when they engaged to audit the cooperative's financial statements in August, 1981. As fiduciaries (within the scope of their services)

Arthur Young was obliged to pass on the propriety of payments of which they were beneficiaries, and therefore had a duty to investigate anew the propriety of that payment. A particularly disturbing question is presented in this connection. If the Co-op *could* legally have made advance payments for White's defense in a criminal case, the statutes seem to require the officer benefitting from that arrangement to indemnify the corporation in the event that he is convicted or in the event that the payment be otherwise objectionable. The use of the word "advance" in the statute conjures up the image of a "loan" to the officer; that is, something that should be paid back. This "loan" however was never made to the officer; rather, it was made to the accounting firm. Leaving all questions aside whether a payment can be termed a "loan" when it was made for services rendered, by legal analysis the obligation was theoretically callable by the corporation directly or by any one of its shareholders derivatively from the accountants for a period of at least three years after the last payment was made, unless the limitation be otherwise extended. Under that analysis, the payment to Arthur Young is "loan-like," since under that analysis Arthur Young would be required to pay the amount back to the Co-op and make its demand for payment on the parties primarily liable: *i.e.*, Ball and Mourton, or Jack White. To what extent is an auditor independent (See, S.E.C. ASR 234)[1] under that characterization of the problem? If he is not "independent" under

---

[1] This Accounting Series Release was recalled by the Securities Exchange Commission in 1981, not because it misstated any principles, but because it was deemed unnecessary.

that characterization, can he pass on the propriety of that transaction in his audit? Does he "toll" the statute of limitations against him, in other words, by issuing an audit report a year later which is silent on whether his services as an expert witness constituted a "related transaction" which needed investigation and/or correction? This consideration impels us to deny Arthur Young's plea of the statute of limitations, which would otherwise be availing since the accountants received their fee more than three years before the commencement of the bankruptcy proceedings. The question of limitation can be, of course, submitted to the jury for decision if Arthur Young so desires.

For these reasons, then, Arthur Young's Motion for Summary Judgment under Count I is denied.

COUNT II. FRAUD, NEGLIGENCE, AND CONSPIRACY IN TRANSFER OF GASOHOL PLANT

A. The Motion of Carl Creekmore

Carl Creekmore, former general counsel of the Farmers Co-op of Arkansas and Oklahoma, Inc., has moved for summary judgment on claims of negligence, fraud, and racketeering brought against him by the bankruptcy trustee for the Co-op, and by the class of members and noteholders of the Co-op. An earlier opinion of the court, *Robertson v. White*, 683 F. Supp. 954 (W.D. Ark. 1986), recited in some detail the allegations against all the defendants in the case. It will not be necessary to repeat all of those. The court will go into greater detail concerning the critical facts surrounding the transfer of the White Flame gasohol plant to the Co-op, and particularly those

circumstances and actions involving Creekmore. Our goal in this recital is to make the kind of findings a reasonable juror could on the basis of the record presented. *See Anderson v. Liberty Lobby,* 54 U.S.L.W. 4755 (June 23, 1986). This is not to say that these "findings" are incumbent on any juror; only that they represent the most favorable findings and inferences a reasonable jury might draw from the conflicting accounts advanced by the parties.

Towards the middle of 1979, Jack White, general manager of the Farmers Co-op, and Edwin Dooley, a Fort Smith businessman with experience in oil and gas, resurrected an old corporation, Big D Solvents, with the idea of building and operating a gasohol plant to make automotive fuel from agricultural products. The two got a loan from the Merchants Bank of Fort Smith and commenced planning the enterprise. White suggests that the one-half interest he owned was always the Co-op's, but a reasonable jury could decide otherwise, since there is scant documentation of his assertion. Furthermore, he claimed White Flame's *entire* loss on his 1979 taxes. In the fall of 1979, Dooley decided to leave the enterprise, and White bought him out, taking a loan from the Citizens Bank of Van Buren. Both White and Creekmore were directors of the Citizens Bank. The loan from Citizens was close to its lending limit for individuals, and when, a year later, it still remained unpaid, the Bank made demands on White.

To get the plant built and into operation, White figured that he would need $3 million in financing, and sought to sell some Act 9 bonds to raise the money. Accordingly, the Little Rock firm of Friday, Eldredge & Clark was engaged to prepare the papers requisite for

that purpose, including an offering statement. A reasonable juror could conclude that Creekmore was acting as White's attorney in this matter, since the Friday firm sent materials to Creekmore under cover of a letter identifying him as White's attorney (Plaintiffs' Ex. 178). The offering statement, a copy of which was given to Creekmore, was hairraising. It is safe to say that none but the most foolhardy would ever have bought bonds whose repayment depended on the success of the gasohol plant.

The court will excerpt certain statements from the bond counsel's report so that one may get a flavor of the discouraging nature of the enterprise. In bold type, the statement says that in the opinion of bond counsel, the bonds were not suitable for investment purposes because of their high risk. Counsel cautioned that the bonds should not be purchased by anyone who could not afford a complete loss of the investment. Inasmuch as Jack White individually was being called on to guarantee the bonds, the statement alerted the reader that one should be wary of the guarantee since it was uncertain that White had the resources to pay it off. Under the terms of the statement, the Farmers Co-op was supposed to buy the bonds, and presumably these cautions were being addressed to the Co-op and anyone purchasing bonds from it.

The offering statement went on to relate that the bonds involved an unusual and substantial degree of investment risk, that they were not suitable for the general public, and that the entire investment stood to be lost. It related that the company was a new entity with no operating history of any type, whose management had no experience, proposing to use an untried process with no

assurance of mechanical success. The Company, related the statement, had no contracts to purchase raw materials and no market for its product. The Company had no resources at its command other than the bond proceeds, no personnel with technical proficiency, and no assured demand for its product. The statement exceeds 40 pages, and is as discouraging a report as one is likely to find.

White dropped the idea of selling bonds to the Co-op at this point, or to anyone for that matter. He began financing the operation out of Co-op cash funds, making notes to it for many hundreds of thousands of dollars at a time, with no security other than his "guarantee." These loans were never authorized by the board. From January, 1980, through October, 1980, they totaled over $4 million.

White claims that in February, 1980, the Co-op board of directors voted to buy the gasohol plant, and Creekmore goes along with this, although he does not recall the exact circumstances of the transaction. A reasonable jury would not be obliged to believe this, however. The minutes are silent on the point, the directors hazy, and the subsequent course of events contrary to the hypothesis. For example, White guaranteed notes from the Co-op to White Flame Fuels (as it was then called) and pursued FmHA financing for the project in his own name, representing the facility as his own. In addition, one board member recalls that a motion was made and seconded to buy the plant in February, but that the motion was withdrawn at the request of Jack White. (McClure Depo., at 118).

Significantly, the contents of the offering statement were never shown to the Co-op by White or by Creekmore, both of whom were fiduciaries. The law required

such a statement to be shown to the board of directors in the event that they were to buy the Act 9 bonds. Of course, in a non-securities transaction, no such statement need be shown. As disclosed later, however, the Co-op, in supposedly buying the plant, purchased the *stock* of White Flames Fuel. The kind of disclosures mandated for securities transactions of that type, however, were never made. *See Landreth v. Landreth Timber Co.*, 105 S.Ct. 2297 (1985).

The gasohol plant began production in April, 1980. All the dismal forebodings of bond counsel were fully realized. The plant, plagued with cost overruns, glitches and snafus, could never sustain production over 25% of capacity, and lost $100,000 a month. Understandably, White was unable to attract FmHA financing for the plant.

In November, 1980, the Co-op board went on record, voting to buy the gasohol plant. The minutes are no more spacious on the subject than that. The record discloses no certain terms, price, time, or anything else considered essential for purposes of contract. White claims that this action was taken to memorialize the February vote. A reasonable jury could conclude otherwise. Evidence shows that a Farmland representative visited the Co-op in November to advise them that they should *not* buy the gasohol plant, and that he was told by White that the plant was still owned by him.

Two weeks after the Co-op voted to buy the plant, Jack White, Hugh Brewer (chairman of the Co-op board),

Carl Creekmore,[2] E.J. Ball (White's attorney on criminal tax fraud charges), and Hugh Hardin met in Hardin's office in Fort Smith. It had been learned that the Co-op might take advantage of certain tax deductions available to the gasohol plant if it could be shown that the cooperative owned the plant prior to the date it commenced production. White and Brewer volunteered that such was the case, and informed the lawyers, Ball and Hardin, that the Co-op had voted in February to buy the plant, but that the vote had not been recorded in the minutes.

Lacking any documentation to show the IRS, in the event that the propriety of the deductions were ever questioned, Ball suggested that the Co-op file a "friendly lawsuit" against White, the purpose of which was to establish ownership by the cooperative on February 15, 1980, more than a month before the plant commenced production.

Creekmore told the lawyers that he lacked expertise and asked Ball, who worked in Fayetteville, to prepare the papers. Hardin volunteered to draft the complaint for the Co-op and deliver it to Creekmore. On November 26, 1980, Hardin delivered the first draft of the complaint to Creekmore, Ball and Gene Kuykendall. This draft recited that on January 1, 1980, White and the Co-op agreed that White should assign his stock to the Co-op, and that the sole consideration for the transfer would come out of the net profits of the plant from 1980 to 1985, but in no case

---

[2] Creekmore denies attending this meeting, but the testimony of Ball and Mourton places him there. For purposes of summary judgment, such evidence would allow a reasonable jury so to find.

more than $250,000. The complaint recited that in reliance on that agreement the Co-op advanced $3.85 million to the plant, but that White refused to tender the stock. The complaint sought a declaration confirming the deal as outlined in the pleading, and an order requiring White to turn over the certificates to the cooperative.

This draft evidently did not satisfy Ball, possibly because the date of the agreement was January 1, 1980, rather than February 15. The complaint was redrafted so that the Co-op became obligated to pay White's $250,000 note to Citizens Bank. Besides that, the complaint recited that the entire amount advanced to the plant as loans guaranteed by White would be "considered the [cooperative's] investment" in the plant. This amount apparently ran to $750,000. The complaint then recited that since February 15, 1980, the Co-op had advanced another $2.98 million to the plant. It asked for a declaration that the stock of the gasohol plant belonged to the Co-op, and that the "deal" be confirmed along those lines.

At the December, 1980, board meeting Creekmore announced his retirement, effective December 31, 1980. He made a report to the board concerning pending litigation, and told them that, in addition, the Co-op's tax lawyers (Ball and Mourton, of Fayetteville, Arkansas, also White's criminal tax attorneys) had recommended that he file a declaratory judgment action to establish the February 15 transfer date. Creekmore avers that he fully informed the board of the terms of the lawsuit; the directors, however, though recalling that the subject of such a lawsuit came up, do not testify that they were fully aware of the intents, purposes, and effects of the suit.

The board passed a resolution empowering Creekmore to do whatever was necessary to get the stock in the Co-op's name, but did not specify that a lawsuit be filed. The next day, Creekmore filed the declaratory judgment action, and the following week, after White filed an answer generally denying the allegations of the complaint, Creekmore, White, Brewer and N.D. Edwards, a Van Buren lawyer recruited to represent White at the hearing, procured a decree from the Chancery Court vesting title to the stock in the Co-op's name, and absolving White of all liabilities. By this time, the gasohol plant was a money pit.

The record is clear that at no time did Creekmore ever reveal to the board that he simultaneously represented Jack White, nor did he ever reveal to the board the information contained in the offering statement concerning the advisability of investing in the gasohol plant. The trustee complains that Creekmore's complicity in this affair constituted negligence, fraud and racketeering, as those terms are understood in the common law, as well as under state and federal securities and racketeering statutes. Creekmore argues that certain of the allegations, notably those of fraud and negligence, are barred by the statutes of limitation, and that the evidence does not show federal securities law and anti-racketeering violations on his part.

On February 23, 1984, the Co-op filed for reorganization under Chapter 11 of the bankruptcy code. A principal question for decision under Creekmore's motion for summary judgment is whether he is chargeable with any act occurring on or after February 23, 1981, that would toll the running of the statute of limitations. Under 11

U.S.C. § 108, statutes of limitations barring a bankrupt estate's causes of action against third parties are automatically extended two years, unless such actions were already barred by the time the reorganization proceedings commenced. In addition, so far as relevant, the class filed its claims of fraud against Creekmore on May 8, 1985. These matters of limitations for the common law counts of negligence and fraud will be taken up first.

(1) STATUTE OF LIMITATIONS

A. COMMON LAW

I. Negligence

The statute of limitations in Arkansas for negligence actions against attorneys is three years. Ark. Stat. Ann. § 37206 (1962 Repl.). In *Riggs v. Thomas*, 283 Ark. 148, 671 S.W.2d 756 (1984), the Supreme Court of Arkansas ruled that the limitations period began to run, absent concealment of the wrong, when the negligence occurs, not when it is discovered by the client. Concealment, however, may not be found when a tortfeasor merely remains silent or fails to publish the fact that he has committed a wrong. *Scroggins Farms Corp. v. McFadden*, 165 F.2d 10 (8th Cir. 1948). To toll the statute, some affirmative act needs to be done, unless there is a duty to speak. *Williams v. Purdy*, 223 Ark. 275, 265 S.W.2d 534 (1954). Generally speaking, knowledge of the wrong done is a necessary prerequisite to a tolling of the statute of limitations by reason of concealment. *Cf. Williams v. Edmondson*, 257 Ark. 837, 520 S.W.2d 260 (1975). That is, one cannot negligently conceal a negligent tort so as to be deprived of the benefit of the limitations defense. An attorney is under no special

obligation merely by virtue of the attorney-client relationship to alert his client that he has negligently performed a task so as to prevent the running of a statute of limitations. *E.g., Fortune v. English*, 226 Ill. 262, 80 N.E. 781 (1907).

There does not appear to be any allegation that Carl Creekmore concealed his responsibility for negligent acts. First, in our opinion denying the motions to dismiss, *Robertson v. White, supra*, at 959, we criticized the plaintiffs' complaint for not alleging particular acts of concealment which would take their cause of action beyond the bar of limitations, *citing Stewart Coach Indus., Inc. v. Moore*, 512 F. Supp. 879 (D. Ohio 1981). We indicated that the limitations questions would likely re-arise on motions for summary judgment, and counsel were alerted to file statements of non-disputed facts pursuant to Local Rule No. 29 as a means of sharpening the concealment issue. To the extent that plaintiff has filed a Rule 29 statement, it is a non-conforming one. Rather than recite material, undisputed facts, it asks a series of argumentative questions, *i.e.*, "What level of expertise can be expected of a former judge (for 20 years)? May he simply defer blindly to other lawyers representing conflicting interests who now disclaim having ever researched the matter, etc.?" One searches in vain for any act of concealment charged by the plaintiff's Rule 29 submission. Creekmore's Rule 29 submission advises that he left the employ of the Co-op on December 31, 1980, and that he last worked on the transaction in question on December 19, 1980. He further says, "At [the Board meeting of December 11, 1980] Creekmore advised the Board that it had been recommended that he file a Complaint on behalf of the Co-op

against Jack White and White Flame Fuels, Inc., and obtain a declaratory judgment on the transfer of the gasohol plant to the Co-op. Creekmore then advised the board of the nature, provisions, and purpose of the proposed lawsuit and the board consented to the procedure." The plaintiff's statement takes no issue with this assertion, but merely questions whether it is true. Under Local Rule 29(c), movant's declarations are deemed to be admitted unless controverted by the defending party within 10 days.

For all practical purposes, the plaintiff has failed to make a showing on concealment at all. Such a showing must be weighty, if the language of *Williams v. Purdy*, 223 Ark. at 279, is to be given any effect:

> There must be some positive act of fraud, something so furtively planned and secretly executed to keep the plaintiff's cause of action concealed, or perpetrated in a way that it conceals itself. And if the plaintiff, by reasonable diligence, might have detected the fraud, he is presumed to have had reasonable knowledge of it.

In plaintiff's brief opposing Creekmore's motion, pp. 2-11, the trustee recites his version of the relevant, material facts very thoroughly. At no point does the trustee suggest that Creekmore did anything *after* December 19, 1980. Rather, to extend the period the trustee *argues* the following: (1) that a conspiracy existed between Creekmore and members of the board to conceal from later board members the facts surrounding the transfer ("Argument" at 13) so that the transfer could be rescinded; and (2) that Creekmore had a duty to advise the Co-op to file a motion to void the decree within 90 days

of its entry, *see* Ark. R. Civ. P., Rule 60(b), for failure of which the applicable limitations period begins running March 19, 1981, or within three years of the date on which the Co-op filed for bankruptcy, an act which extended the limitations period for nonbarred suits, and would presumably save this suit.

The record offers no proof of an agreement between Creekmore and the board members that details should be hidden from members who should later come on board. The court views plaintiff's suggestion that there was such a conspiracy as merely tendentious. After *Celotex Corporation v. Catrett*, 59 U.S.L.W. 4775 (June 25, 1986), a party moving for summary judgment is not required to "support its motion with affidavits or other similar materials *negating* the opponent's claim." Rather, *Celotex* teaches that the non-moving party must "go beyond the pleadings and by her own affidavits, or by the 'depositions, answers to interrogatories, and admissions on file,' designate 'specific facts showing that there is a genuine issue for trial.' " The evidence which the trustee advances to support his contention that there was a conspiracy among Creekmore and certain Co-op directors to conceal Creekmore's negligence consists of the following two statements from directors, both of whom were *not* on the board in December, 1980 (Harris and Willis). Harris declared:

Q. Before you found the friendly lawsuit at the courthouse, did you ask any of the members that were still – that were on the board back in 1980 how the Co-op had acquired the gasohol plant?

A. Yes.

Q. Do you recall which members you asked?

A. At the board room, and as we talked about it, we were asking anyone, at the same time we were talking about how we owned it. *Anyone would have had the opportunity to have said "Oh I know" if they knew or wanted to give out that information.*

(Harris Depo. at 71).

Similarly, in the deposition of James Buel Willis, the following exchange is found:

Q. . . . did any of the directors that you discussed this with question [the decision to acquire the gasohol plant on February 15, 1980]?

A. *The ones I recall that I talked to didn't know any more about the decree than I did.*

Q. By that you mean they were not even aware of the decree?

A. That's what I understood. I wish I could be more specific on it, but that's my recollection.

(Willis Depo., at 51).

From these circumstances, the plaintiffs appear to infer or argue conspiracy to defraud. (Plaintiff's Brief at 13). It is clear, though, that in Arkansas, stronger proof of conspiracy is needed.[3] In *Fidelity Mutual Life Insurance Co. v. Price*, 180 Ark. 214, 220, (1929), the court noted that "in

---

[3] This discussion concerns only a conspiracy to conceal a cause of action for negligence. The court believes that a jury can find a conspiracy to defraud involving Creekmore.

order to establish a conspiracy to defraud, the evidence must do more than excite suspicion; it must *lead to belief.*" (emphasis added). The court said that evidence which was "slight and equivocal" was unsatisfactory for the purpose. In *Fidelity Mutual*, plaintiffs sued to collect on a policy of insurance which had previously been assigned by the decedent to a bank. The evidence showed that shortly after decedent's burial, a family friend wrote to the insurance company and informed it that the decedent owed no debts to the bank (a former judgment having been taken solely *in rem*) and enclosed a copy of the court decree. The bank to whom the assignment had been made was owed a considerable portion of the underlying debt, the judgment property being insufficient to satisfy it. As it happened, the officer to whom the letter was delivered was also a director and stockholder in the bank. The evidence showed that the bank had released the assignment of the policy some time previous to the decedent's demise. Nevertheless, the insurer's officer, Bright, paid the policy to the bank pursuant to the written assignment, and the heirs sued his company and his bank for conspiracy to defraud. In circumstances far more compelling than these here presented, the Supreme Court found there to be no substantial evidence from which conspiracy might be found. The court's reference to evidence sufficient to "lead to belief" is the equivalent of "clear and convincing evidence."[4] In the recent case of *Kelly v. Kelly*, 264 Ark. 865, 575 S.W.2d 672 (1979), the clear and

---

[4] Black's Law Dictionary, 5th ed., p. 141, defines "belief" as "a firm conviction as to the allegation sought to be established."

convincing standard was equated with one which produces in the trier of fact "a firm conviction as to the allegation sought to be established." The recent case of *Anderson v. Liberty Lobby,* 54 U.S.L.W. 4755 (June 23, 1986), says that summary judgment may be entered against a party burdened by the clear and convincing proof standard by "consider[ing] whether a reasonable fact finder could conclude, for example, that the plaintiff had shown actual malice with convincing clarity." *Id.* at 4758. In making this determination, the court is not to make credibility determinations, but must believe the evidence of the non-movant, and *all justifiable inferences are to be drawn in his favor. Id.* at 4759. The court does not believe that reasonable jurors could conclude that because two directors were unable in 1982 to obtain information at a board meeting about the chancery court action in 1980, that it follows in any sense that the other directors had conspired with Carl Creekmore to suppress information about how the decree was taken. This airy chain of inference is forged with links of mist. *Anderson* says, at the very least, that one who charges conspiracy must offer some "concrete evidence" and may not "merely assert that the jury might, and legally could, disbelieve the defendant's denial of a conspiracy. . . . " *Id.*

The record, then, discloses no act of *concealment* by Creekmore, nor by anyone else which would properly be chargeable to him. The trustee suggests, however, that Creekmore's failure to advise the board that it could petition the Crawford County Chancery Court to vacate the decree was an additional act of negligence on his part, which continued, according to the trustee, until March 19,

1981, which the trustee argues is the last date such a motion could have been made.

The trustee is here referring to Arkansas Rules of Civil Procedure (ARCP) No. 60, which holds that motions to vacate judgments and decrees can be made for specified reasons up until 90 days after the rendition of the decree. ARCP 60(a). That rule provides that a party can obtain relief from a judgment within 90 days of its entry if the party's motion advances grounds which would have been a basis for such relief under prior law upon a motion made before the expiration of the term of court. Such grounds, prior to 1970, were confined to the grounds for a new trial. *See* Pope's Digest §§ 1536, 1539. These include jury misconduct, accident, surprise, newly discovered evidence, etc., none of which are germane to our inquiry.

Under Rule 60(c)(4) a party may obtain relief from a judgment even after 90 days for "fraud practiced by the successful party in obtaining the judgment." This accords with prior law, which permitted motions to vacate judgments to be filed even after the expiration of the term of court for "fraud practiced by the successful party in the obtaining of the judgment of the court." Pope's Digest § 8246. There is no limitation on such a motion. It could have been brought at any time before or after the term of court under the old rule, or, under the new rule, before or after 90 days.

The question now becomes whether an attorney who *negligently* represented his client in such a way as to allow an opposing party fraudulently to obtain a judgment against his client can ever successfully plead the

statute of limitations to bar an action of negligence brought against him. Theoretically, according to plaintiff, he never could. A remedial step lies always within his power to initiate. This, of course, assumes that he becomes *aware* that a fraud was practiced on his client after the judgment was obtained. Under the rule of *Williams v. Edmondson*, 257 Ark. 837, 520 S.W.2d 260 (1975), the plaintiff must show knowledge of the wrong done, acquired after its commission, in order to argue that the statute should be tolled because of failure to remediate. This record is barren of any suggestion that Creekmore learned of his alleged "negligence" in having obtained the decree, and failed thereafter to inform his client of steps which could have been taken to undo the damage caused by the chancery court judgment.

For the above reasons, then, summary judgment will be entered in favor of Carl Creekmore against the trustee on all claims of negligence. The court finds that they are barred by the applicable statute of limitations, and that the trustee has submitted no proof of any act of concealment chargeable to Creekmore that would bring his action for negligence beyond the bar of limitations.

II. Fraud

Creekmore urges that the action for fraud and deceit, too, be barred by limitations. Such act was, also, one governed by the three-year limitations period established by Ark. Stat. Ann. § 37-206. *Hughes v. McCann*, 13 Ark. App. 28, 31 (1984). Instead of running from the date of the fraudulent act or misrepresentation, however, the limitations period is not tolled until the injured party could

have discovered the fraud in the exercise of reasonable diligence. *City National Bank v. Sternberg*, 195 Ark. 503, 114 S.W.2d 39 (1938). In cases of fraud involving attorneys and fiduciaries, failure to discover the facts constituting fraud is more easily excused. 37 Am. Jur. 2d *Fraud and Deceit* § 409 at 555.

A "fiduciary relation" exists between an attorney and his client, requiring the attorney to act in the utmost good faith. The lawyer must not only not misrepresent any facts to his client, but there must be an entire absence of any suppression of facts within the attorney's knowledge which might influence the client. The burden of establishing the fairness of the transaction is on the attorney. *Chavis v. Martin*, 211 Ark. 80, 199 S.W.2d 598 (1947).

The trustee has alleged that Creekmore represented conflicting interests in November and December, 1980; those of Jack White, by whom he had been privately employed to help secure financing for the gasohol plant, and those of the Co-op. The trustee alleges that Creekmore never revealed to the board that he had represented White. The trustee alleges that Creekmore failed fully to advise the board of the "pros and cons" of the transaction. The trustee has shown that Creekmore was on notice as early as January, 1980, that the gasohol plant was a financial disaster waiting to happen. White, however, was undeterred by the dire warnings of bond counsel and determined to "go ahead." He commenced borrowing large sums of money from the Co-op even before February 15, the date when the board supposedly voted to buy the plant. Creekmore never told the board of the information he had acquired that might have influenced their decisions in February, 1980. Thereafter, in November,

1980, when the board voted "officially" to buy the plant, Creekmore raised no demur. He never suggested that White share the losses in any way. His silence can certainly be seen as having been "in aid of" his client, Jack White. Finally, in December, 1980, the lawsuit essentially "fixed the terms" of the transaction: White formally transferred his shares; the Co-op effectually released White on his guarantee and also paid White's note of $250,000 to Citizens Bank. Creekmore was, at the time, a director of the Citizens Bank of Van Buren, an enterprise which stood to profit from the arrangement by having its loan fully paid.

The court feels that there is sufficient evidence upon which a reasonable jury might find, clearly and convincingly, that Carl Creekmore actually defrauded the Farmers Co-op, for the benefit of Jack White and possibly the Citizens Bank, of which he was a director. Where fraud is pleaded against a fiduciary such as an attorney, the rule relaxing the statute of limitations is often invoked to excuse one's failure to discover the facts constituting the fraud. The decree was taken December 19, 1980, and can therefore be said to be the "last act" in a fraudulent scheme spanning nearly a year. The court cannot say that as a matter of fact or law the circumstances of the fraud should have been discovered within two months. Creekmore has cited us to no event or circumstance occurring between December 19, 1980, and February 23, 1981, which would have put the board on notice that it should have scrutinized *his* dealings with the Co-op more closely. In the absence of such a circumstance, it would be plainly arbitrary for the court to hold, as a matter of summary judgment, that the alleged fraud

should have been discovered within 66 days of its completion.

The court will therefore deny Creekmore's motion for summary judgment on the common law fraud claims brought against him by the trustee.

B. THE MOTION OF ATTORNEYS BALL, MOURTON, & ADAMS

E. J. Ball and Ken Mourton, (as well as their then-associate and current partner, Steve Adams,) have asked for summary judgment on Count II, which charges them with fraud, negligence, and conspiracy to commit fraud with respect to the transfer of the gasohol plant to the Co-op. It appears that Ball and Mourton were hired by the Co-op, *via* Jack White, in May, 1977, to represent it in a civil and criminal tax investigation which the IRS had commenced. On September 5, 1980, the Grand Jury charged Jack White with filing a false tax return (2 counts) and conspiracy to file a false tax return (1 count). In the body of the indictment, the Grand Jury asserted that White had been guilty of self-dealing with the Co-op, and that White and Kuykendall conspired to conceal this fact from the IRS. We have had previous occasion, in the discussion of Count I, to suggest that a reasonable Juror could find that this allegation was capable of putting one on notice that White's loyalty to the Co-op was suspect, and that the interests of the Co-op and its fiduciary White were potentially in conflict, at least with respect to matters raised by the indictment.

On November 12, 1980, Ken Mourton appeared at a meeting of the Co-op board to discuss with them his

firm's preliminary findings and recommendations regarding the Government's civil claim for over a million dollars in back taxes. His report was lengthy, taking until lunch to conclude. Mourton left the meeting at this point. When the meeting reconvened, Jack White told the directors that Mourton had advised him that they needed to document their transactions better, and specifically referred them to an alleged earlier determination to buy the gasohol plant from him, a decision which was not reflected in the minutes, or recorded in any other document such as a deed or contract. The board then voted "to buy the gasohol plant." (Ex. 1528) In many respects, this construction of the evidence is the one most favorable to Ball and Mourton, since it suggests that the Co-op board had actually voted at some time before November, 1980, to buy the gasohol plant, a matter highly disputed in this case. The minutes reflect only that the board "voted to buy the gasohol plant." No terms were set, nor was anyone directed to compose any documents of sale setting forth the terms and conditions of the purchase.

A reasonable jury could find that in February, 1980, the board "talked about" acquiring all of White's interest in the plant, but that the motion was tabled at White's suggestion. The plant had not commenced production at that point, and held at least a promise of profitability. If it were able to produce at or near capacity (9,000 gallons a day), White stood to make a considerable profit on his investment. White may therefore have suggested that the question be held in abeyance so that he could monitor the plant's production and thereby "play the odds," dumping the plant on the Co-op if it couldn't make a profit, negotiating a lucrative sale to the Co-op if it made money.

One reviewing the record is struck by the ambiguity of the Co-op's relationship to an investment as large as a gasohol plant. Apparently, such ambiguities characterized the way White and the Co-op did business. One of the thirty-four "overt acts" specified in the indictment charged that White had participated in a venture with a local produce broker named Gunn, and that the two used Co-op facilities. The entity, called Gunn-White Produce paid "rent" to the Co-op, which ordinarily would be fully taxable, being otherwise disqualified from a characterization as patronage-sourced income. White claimed at his trial that he really "represented the Co-op" in the transaction, although there was no documentation for the assertion, and all available documentation (Gunn-White checks marked "rent") pointed to the contrary. This parallel was appreciated by Mourton, who testified in a deposition that when he heard in November that the Co-op had supposedly bought Jack White out in February, he thought to himself that it sounded a lot like the Gunn-White transaction.

There appears to be little support for a finding that the Co-op owned the plant as of February 15, 1980. The earliest indication that the Co-op had indeed bought the plant appears in the November, 1980 minutes. These minutes were absent from the Co-op's record books for several years. It appears that the handwritten originals of all the corporate minutes were collected by Ball and Mourton in preparation for the trial, including the November minutes which had not been typed by the Co-op staff. Undoubtedly, they were kept by mistake, under the impression that the typed copies were at the Co-op available for inspection. In any event, documentation which

would have alerted an auditor to "re-check" the Chancery Court lawsuit was absent from the Co-op, and the significance of that absence and its bearing on the suit is a matter of argument.

On November 25, White asked to have a meeting with E. J. Ball to discuss some Co-op business. He explained to Ball, who may have been unaware of the November 12th vote, that the Co-op lacked documentation for its ownership of the gasohol plant. White wanted to know what method could be used to certify the Co-op's ownership of the plant. Ball suggested that a declaratory judgment action could be filed reciting White's agreement to transfer the shares, and his failure to do so, praying for a judicial declaration that he was obliged to transfer the shares, and had been as of February 15, 1980.

Were the proof to have concluded at this point, we should have little hesitance in deeming it inadequate to prove actual fraud, although an inference of negligence could be drawn, because of Ball's failure to investigate an unrecorded decision to buy from White a $4 million "White Elephant." Even a minimal investigation would have revealed that the Co-op was not bound to bail White out. After the meeting, Hardin sent Ball a draft of a complaint he had prepared which "got everything wrong": the date, the terms, the pay-out, everything. Ball answered interrogatories admitting that he redrafted the complaint. The redrafted complaint has substantially different terms, and is significantly more advantageous to White giving him, outright, $250,000 in benefits which, in the first draft, were contingent on profitable operation of the facility. Ball now denies having amended the complaint. His interrogatories, however, were signed even if

not notarized, and are therefore admissible evidence as a statement by a party opponent. Federal Rules of Evidence, Rule 801(d)(2).

Plaintiffs argue that baneful and fraudulent motives abound for Ball's actions; Ball insists that he was just trying to be helpful. The court is struck by how closely, in many ways, this situation resembles one which unfolded seven decades earlier in the career of Justice Brandeis, when he was a practicing attorney. A party came to him for advice and apparently did not realize that Brandeis' firm represented an interest antagonistic to his. Brandeis counseled him to pursue a course of conduct which the client later had second thoughts about, and wanted to rescind. He levelled charges of fraud against Brandeis, who denied that he did anything more than counsel the individual how best to effectuate the dissolution of his business and the payment of his creditors. The individual's new lawyer had decided that an assignment for creditors was not such a good idea, and challenged Brandeis to reveal just whose interests he thought he was protecting when he gave the initial advice. Brandeis replied: "I should say that I was counsel for the situation." *Hearings Before the Subcommittee of the Senate Committee on the Judiciary on the Nomination of Louis D. Brandeis to Be an Associate Justice of the Supreme Court of the United States*, 64th Cong., 1st Sess., sec. 6926, at 287 (1916).

It is perfectly inferrable that Ball, in the unfortunate but apt phrase of Brandeis, was "counsel for the situation," suggesting an expedient, problem-solving procedure for accomplishing what everybody seemed to want. Such a voluntary service may not be negligent,

although, once undertaken it must be pursued in a diligent, careful, and conscientious manner, particularly where the service was, as here, fully compensated by the Co-op. Such a duty may require minimal investigation, particularly where White's dealings with the Co-op appear to have been conducted at less than arm's length.

Lack of care may also be inferred from the fact that one who counsels corporations and their fiduciaries have to be on the alert whenever there is traffic between the two. To be frank, there appears to be a unanimity of opinion that Jack White was essentially unchecked by anybody at the Co-op: what he said, the Co-op did, and board meetings and resolutions were mere formalities along the way. The Arthur Young accountants realized this: they commented on it in their work papers. (Exhibit 855). A jury may conclude that White, who was *at least suspected* of fraudulent activity *vis a vis* the Co-op, made what should have been a surprising suggestion to Ball who, rather than investigate its *bona fides,* blindly facilitated the perfection of a transaction which dearly cost his other client, the Co-op. Even though we as a society strive to accord to all our citizens the right to be presumed innocent until proven guilty, there are limits to the application of that doctrine. A reasonable jury could well conclude that in any transaction involving White and the Co-op, after the indictment, red flags abounded to those who wanted to see them.

The jury may further conclude that conduct of Ball and Mourton was reckless which, in the context of fiduciary relationships, is all that plaintiffs need to show to submit a claim of fraud to the jury. After the November

25 meeting, Ken Mourton went to Kansas City and conferred with specialists in co-operative taxation and accounting about the "tax advantages" for the Co-op if the transfer could be established as having occurred on or before the date when the plant commenced commercial production. It appears that there were none. Mourton apparently told Ball that this was the case in a telephone call from Kansas City. The reason for establishing an early date for the acquisition of White Flame Fuels by the Co-op had disappeared for all but one party; Jack White, who stood to improve his personal balance sheet considerably if he had documentation to support his non-involvement with the plant. For one thing, his $4 million debt to the Co-op would disappear. Second, if the lawsuit were properly worded, the Co-op stood to relieve him of obligations to pay hundreds of thousands of dollars of loans to local banks. If, indeed, there was any other motive than to benefit Jack White by going ahead with the "friendly lawsuit," the court cannot find it. The lawsuit was plainly *inadvisable* absent that circumstance. Why, a jury may inquire, would a criminal defense attorney subject his client to news stories which would report that his client had "been sued" by the Co-op three weeks before trial started in a case involving his client's course of dealings with the Co-op?

On December 9, 1980, apparently aware that there was no real rush to document the transfer of the plant to the Co-op, Ball took the redrafted complaint, answer, and decree to Creekmore for filing and execution. The evidence would freely permit a reasonable juror to conclude that the transaction was designed solely to benefit White – or at least that on balance the financial benefits to be

gained by him outweighed, in White's mind, the possibly ephemeral effects of bad publicity on the eve of his trial. If the transaction were *that* advantageous to White, one who represented the Co-op's interests would have had to have wondered why it was such a good idea for the Co-op.

Situations such as these are sometimes the unfortunate fallout from acting as "counsel to the situation." Unless one really has a client, one really has no interests to protect, and no real curiosity about the matter. That can be non-negligent, of course; or it can be negligent, reckless, constructively fraudulent or actually fraudulent. The court cannot decide the issue on defendants' motion for summary judgment. In plain words, there is ample evidence rationally to sustain any one of the possible conclusions. This is especially so where one finds that a "sweet deal" was made even sweeter for White by the redrafted complaint, a circumstance for which there is no compelling explanation.

Furthermore, plaintiffs' expert witness, Drew Kershen, has testified that Ball and Mourton were representing conflicting interests. This opinion alone, if not unreasonable, would raise a fact issue incapable of resolution by summary judgment. Generally speaking, an attorney may be liable to his client for losses resulting from the representation of adverse interests. *Rolfstud, Winkjer et al. v. Hanson*, 221 N.W. 2d 734 (1974). An attorney who, even with the consent of the interested parties, represents such adverse interests may be liable for loss sustained by one of them due to the attorney's failure to disclose a material fact. *Johnson v. Andrade*, 54 S.W. 2d 1029 (Tex. 1932). The jury may conclude that a

cursory inquiry by Ball and Mourton would have revealed to them that the Co-op could lawfully disaffirm whatever ambiguous relationship existed between it and the gasohol plant. In such a circumstance, the Co-op might have wanted to investigate anew whether it was a good economic idea to buy the plant at a price which guaranteed White no losses. "Partners" share losses, unless one doesn't watch out. Nothing could have been easier than to have called a special meeting of the board to ventilate all the considerations so important to such a critical decision.

The court would make it clear that this question is not one resolvable solely by reference to the Canons of Ethics. The basis for this civil action is the common law of fiduciary obligations. *Fielding v. Brebbia,* 399 F.2d 1003, 1005 (D.C. Cir., 1968). Whether or not a breach of that obligation has occurred *may* be determined by reference to the standards set forth in the Disciplinary Rules. *Jeffry v. Pounds,* 67 Cal. App. 3d 6 (1977). We interpose this distinction in response to defendants' suggestion that the court make a ruling on the merits since the simultaneous representation of White and the Co-op was not in contravention of the Canons. (Defendants' Reply, Part IV A). Their authority, *American-Canadian Oil & Drilling Corp. v. Aldredge & Stroud,* 237 Ark. 407, 373 S.W. 2d 148 (1963) does not hold, as defendants suggest, that where the questions for decision implicates the Canons, there is never a question for a jury to decide. That would be an odd holding to announce in the context of an appeal from Chancery Court. *American-Canadian's* reference to such questions as being "ones of law" means only that the Canons *do not absolutely exclude* the possibility that a

lawyer might ethically represent parties with nominally opposing interests. If that were the case, Aldredge and Stroud would have had to have surrendered their fee with no further inquiry. The court said, however, that "[t]he primary question for determination is whether the attorneys did, *either in fact or as a matter of law,* represent conflicting interests. . . . " *Id.*, at 409. Inasmuch as Aldredge and Stroud's representation was not excluded as a matter of law, the court then made a factual inquiry to determine whether, *in fact,* the interests were in conflict. The decision recognized that the existence of a conflict is primarily a factual question. In this case the inferences to be drawn from the facts are competing and far from clear.

An attorney may represent two parties where "it is obvious" that their interests do not conflict. A jury may decide that it was not at all "obvious" that the interests of White and the Co-op were in harmony. They may then proceed along further avenues of inquiry. The Code does not indicate how "clear" a conflict must be in order for dual representation to be impermissible. The court infers from this that the community, as embodied by the jury, has a role in deciding such questions, bringing to bear their own experiences in life.

This inquiry, as we have suggested, may support a finding that Ball and Mourton were reckless. This permits an inference of fraud: as a matter of law, in fiduciary contexts, where a finding of recklessness may be made, a question of fraud *has* to be submitted to the jury. A finding of actual fraud by the jury would render moot any reliance on the formalistic propriety of the activities in question under the Canons of Ethics.

A finding of fraud based on evidence of recklessness would also permit the jury to conclude that the defendants conspired with others to damage the Co-op. Moody, in his motion for summary judgment, correctly pointed out that one cannot recklessly join a conspiracy. We hold that to be undoubtedly true. Recklessness in a fiduciary relationship *permits* but does *not require* a finding of fraud. The jury may find recklessness and decline to find fraud. Fraud is a matter of positive intent, a subjective and interior mental attitude rarely capable of direct proof. Permitting the inference to be made on evidence which, in a non-fiduciary context, would not otherwise suffice, simply recognizes the distinctiveness and the importance of the context. Collaterally, it has the effect of reinforcing the fiduciary's duty to handle his ward's affairs with care. Simply stated, the law demands more of fiduciaries.

If the jury makes the permissible leap from recklessness to fraud, there is no impediment against their finding a conspiracy to effect it. The parties to this transaction worked quickly and in co-ordinated fashion, pursuant to an agreement. In this case, the "agreement" to formally document the transfer of the gasohol plant to the Co-op by concerted action exists and is admitted by all. The argument is whether the agreement was intended for ill or not. There can be no question but that Ball advised the procedure, and that Creekmore consented to effectuate it. Depending on their intent, the agreement was either innocently, negligently, recklessly, or fraudulently made. Either of the latter two findings will permit the jury to conclude that the suit was the product of a civilly actionable conspiracy. It is not necessary that a civil conspiracy

be proved by direct evidence. "That some links in the chain of conspiracy. . . . to defraud have been forged from circumstantial evidence, and in the fact of a flat denial thereof by one of the defendants, does not weaken the finding of the jury." *Johnston v. Andrade, supra,* at 1030. In most cases, conspiracy counts are dismissed because of an absence of evidence that parties acted pursuant to an agreement. Here an agreement of some kind is admitted. We therefore believe that plaintiffs may submit this case to the jury against Ball and Mourton individually, as joint tortfeasors, and as conspirators.

In conclusion, summary judgment will be denied Ball and Mourton on their motion in opposition to Count II of the Consolidated Complaint. As we have stated in response to Creekmore's motion, the fact that more than three years passed since the conclusion of the alleged fraud in transferring the gasohol plant to the Co-op does not necessarily absolve them by a plea of limitations, since a more relaxed rule is involved in cases wherein fiduciaries are said to have defrauded their wards. The defendants will be permitted, evidence allowing, to submit instructions asking that the jury consider the limitations defense, the defense of ratification, or any other matter upon which the evidence permits a finding. It would be plainly arbitrary for the court to declare that the White-dominated Co-op Board should have discovered the alleged fraud within sixty-six days of its completion, or that any Co-op shareholder should have discovered the "true" state of affairs and commenced a derivative action.

A more vexing question is presented with respect to the negligence claims against Ball and Mourton, or for

findings of recklessness in the absence of fraud. A single consideration prevents our granting summary judgment on those claims. The Arthur Young auditors sought information about White Flame and sent a letter to Ball and Mourton, asking for data relevant to their audit. Mourton responded, saying that the only thing Ball and Mourton knew about White Flame Fuels, Inc. was that it was being audited for 1980.

Creekmore, as we have said, did nothing after his term of employment with the Co-op that concealed in any way any possible negligence on his part. We are furthermore of the opinion that one loses his right to the repose promised by the statute only where he fraudulently and knowingly conceals his former negligence. We are frankly hesitant to permit the plaintiffs to proceed on a theory of negligence or mere recklessness against Ball and Mourton, but are not satisfied on the state of this record to grant the summary judgment. For one thing, the letter was, in a sense, untrue: Ball and Mourton did know that White Flame was allegedly purchased by the Co-op in February, 1980, a fact which, if given to the auditors, would cause a number of problems, if only for Arthur Young. Furthermore, Mourton in his affidavit did not explain the letter, and Ball's affidavit refers to (but does not produce) a letter from White which would otherwise put Mourton's response in context. Because it is possible, in a fiduciary context, for a failure to disclose to be fraudulent, Mourton's letter may not have "disclosed enough" to survive a plea of tolling on a motion for summary judgment. The court may be willing, at the conclusion of the evidence, to take this question from the

jury, but frankly hesitates to do so now, in the absence of a firmer conviction, supported by the record.

Finally, Steve Adams' motion for summary judgment is granted, not only as to this count, but as to all others. His liability for the acts of Ball and Mourton extends only to his interests in the partnership, except for those damages legally chargeable to the firm after January 1, 1982.

IV. Count III: Securities Fraud in Transferring White Flame Stock To The Co-op

The Consolidated Complaint charges Ball and Mourton, and Carl Creekmore, with securities fraud in connection with the transfer of the shares of White Flame Fuel to the Co-op. As we mentioned in our opinion on the motions to dismiss, *Robertson v. White*, 634 F. Supp., at 969, this cause of action may be pursued only by the "buyer", i.e., the Co-op.

Ball and Mourton argue that the state securities law complaint should be dismissed as to them because they were not "controlling persons" under the statute; because they had no knowledge of any untruth or omission with regard to the transfer; and because they did not materially aid the transfer, or otherwise act recklessly. (Ball and Mourton, Motion for Summary Judgment, Brief, p. 32).

Ball and Mourton argue that it is undisputed that the transfer of the gasohol plant happened before the November 25th meeting with White during which they merely suggested a way by which the transaction might-properly be memorialized and documented as having

occurred on February 15. Consequently, they suggest there can be no securities fraud chargeable to them because the transaction was final for all intents and purposes before they did anything. Their function, the argument goes, was merely clerical, and if vulnerable to attack for that reason, could only be redressed under common law counts for negligence and fraud, whose elements and damages differ from those permitted under the Arkansas Securities Law.

First, as the court has had occasion to observe, in connection with our opinion denying plaintiffs leave to amend their complaint, *Robertson v. White*, CIV-86-2044 (W.D. Ark. slip op. May 16, 1986) it is extremely doubtful that a jury would find that Jack White parted with his interest in the gasohol plant on February 15. He continued to make sworn representations to all and sundry that he owned the plant. In any event, the evidence on that point is such that a reasonable jury could find indeed that no decision had been made by the Co-op board to buy the plant.

Second, as we have observed, the minutes of the November 12 board meeting say only that the board voted to buy *the gasohol plant*. No terms were specified, and a jury can find that no contractual obligation existed which bound the Co-op to do anything at all. Furthermore, the minutes reflect that the Co-op board voted to buy *the plant*, not the stock of White Flame Fuels, Inc. One can buy all of a corporation's assets, and none of its stock, and thereby avoid securities laws problems. As Mr. Justice Stevens dissenting in *Landreth Timber Co. v. Landreth*, 53 LW 4602, 4607 (1985) said "[i]t is only a matter of interest to the parties whether the transaction takes the

form of a sale of stock or a sale of assets," a circumstance from which he argued that the Federal securities law should not apply to sales of a business involving transfers of stock. In Justice Stevens' mind, securities questions could be avoided entirely by a contractual provision in which the buyer would elect to buy all the assets of a corporation, and none of its stock. The court majority, however, applied the "plain language" of the federal securities statute, which by its own terms governs the sale of "any security," including "stock."

Under this analysis, it may very well be that it was Ball and Mourton alone who were responsible for introducing "securities issues" into the situation. It is very doubtful, viewing the record in the light most favorable to the *moving* party, that a jury would find that the Co-op board had voted to buy White Flame's *stock*. We do not therefore accept the suggestion that a securities transaction had been completed before November 15, 1980, even if the Co-op were contractually bound to "buy the plant," a matter which is highly disputed.

Defendants also suggest that Ball and Mourton were not controlling parties of Jack White, and were not employees of White Flame who "materially aided" the sale of the security. An attorney for a seller of securities can be considered a controlling party if he assists in preparing circulars or opinion letters containing incorrect information. *SEC v. Frank,* 388 F. 2d 486 (2nd Cir. 1968); *SEC v. Spectrum Ltd.*, 489 F. 2d 535 (2nd Cir. 1973); *Felts v. National Accounting Systems Associates, Inc.*, 469 F. Supp. 54 (N.D. Miss. 1978). Such a level of assistance is not materially distinguishable from that alleged to be present in this case, *i.e.*, preparing all the documents for the

transaction, and designing it in a way so as to implicate the securities laws.

In addition, the state securities act enumerates the parties against whom purchasers *may* prosecute an action. The law does not purport to say that such parties are the *only* ones who could be responsible under the law, since such a limitation would conflict with its broadly remedial purpose. Indeed, Ark. State. Ann. § 67-1256(h) asserts that the rights granted under the law are in *addition to* others which exist in law in equity. Rights against joint tortfeasors are established by law, and extend beyond the principal actor to embrace parties who advise or encourage him to commit a particular act, *see generally, Lewis v. Mays*, 208 Ark. 382, 186 S.W. 2d 178 (1945), or those who, having a duty to speak out, remain silent. We believe that a reasonable jury could conclude that Ball and Mourton are liable under both statutory and common law theories. Defendants also argue that they have established the good faith defense set forth in Ark. Stat. Ann. § 67-1256(b). The court believes that a jury question has been made out on that issue, as well.

The lawyer defendants also protest the legal sufficiency of actions brought against them under the Federal securities laws. They argue in this connection that since they did not sell the White Flame securities, their liability is limited to "aider and abetter" liability, which requires the existence of a primary violator (*e.g.*, White), knowledge of his violation, and substantial assistance. For reasons discussed generally before, the evidence will permit an inference that Ball and Mourton owed a duty to the Co-op as its own lawyers in the transfer of White Flame shares to it. Although the proper delineations of who

represented whom are lost in the murky depths in which one sometimes finds himself when he undertakes "to counsel a situation," plaintiffs argue that at his deposition Mourton said he believed that the firm was representing the Co-op: If that was the case, the firm owed duties to the Co-op relative to the transfer, even though such duties were otherwise beyond the original scope of their representation.

As we have mentioned, a jury may infer recklessness, given that Ball and Mourton gave credence to parties who could not document a highly questionable assertion, and who appeared to be ready to accomplish their goal by a means which Mr. Ball thought clearly fraudulent (backdating the stock). One of the parties at the meeting (White) stood accused of self-dealing; another (Brewer, Chairman at the Co-op board) was an unindicted co-conspirator; and the third, Creekmore, was absent from the February 15 meeting at which the deal was allegedly struck, and was in no position to confirm or deny details. Ball and Mourton cannot claim that Creekmore clearly misled them at that time, at least for purposes of summary judgment, since Creekmore denies being present at the November 25th meeting. This is all a very long way of saying that this matter cannot be concluded on summary judgment. The court declines to repeat, again, all the facts and circumstances from which a jury can infer recklessness, or fraud. Suffice it to say that plaintiffs have made a jury question on *scienter.*

The court believes, also, that plaintiffs have proved substantial assistance. Defendants admit counselling the means by which the transfer would take place, supervising the preparation of the documents, and delivering

them for ultimate approval by the Court, as well as counselling that the interests to be transferred be specified as securities. It appears on the face of the record, from defendants' admissions, that their input was the *sine qua non* of a securities transaction, and the only real question appears to be *scienter,* which as we say is subject to conflicting inferences.

That which we have asserted with respect to Ball and Mourton's motion applies as well to Creekmore's. The inference of *scienter* is much stronger in his case, since he presumably knew, far in advance, that the gasohol plant was an unwise investment, and concealed that fact from the Co-op, suppressing the bond offering statement which was intended to have been read by the directors before approving an investment in the plant. If that information was relevant for a decision to buy bonds, it was relevant for a decision to buy stocks. Furthermore, Creekmore substantially assisted the transfer by acting as Co-op counsel in the suit, and procuring the decree. His motion for summary judgment on Count III will also be denied.

We believe, therefore, that plaintiffs may present to the jury a claim for securities fraud and conspiracy against Ball and Mourton, and Carl Creekmore, in connection with the December 19, 1980, transfer of shares in White Flame Fuels, Inc., to the Farmer's Co-op. Inasmuch as the statute of limitations under the state and federal acts is five (5) years, questions on that defense will not be submitted to the jury.

V. COUNT IV: NEGLIGENCE AND FRAUD IN ALLOWING THE CO-OP TO CONTINUE IN OPERATION AFTER INSOLVENCY

Count IV survived motions to dismiss directed against both the class and the trustee. At the time of our rulings on the motions to dismiss, the contours of the rights severally asserted by the Co-op trustee, and by the class, were not known. Now that the record is cleared, the court can proceed to adjudicate the motions directed against these causes of action. The count alleges that the directors, lawyers, and accountants wrongfully prolonged the operation of the Co-op, deepening its insolvency, and rendering its creditors less secure. The complaint asserts that this cause of action is based on one filed by the Superintendent of Insurance in *Schacht v. Brown,* 711 F. 2d 1343 (7th Cir. 1983). That action, in its turn, found its moorings in Illinois corporate law, and statutory law governing insurance companies. *Id.,* at 1345.

The common law of Arkansas does not recognize a separate tort of "managing an insolvent corporation." We believe, in fact, that very few jurisdictions hold to such a view any longer. Some jurisdictions early on held that it was *prima facie* fraudulent for a director of an insolvent corporation, knowing its true condition, to accept an extension of credit, *see Cassidy v. Uhlmann,* 170 N.Y. 505, 63 N.E. 554 (1902). Such views were not uniformly held in America, *see e.g., United States Fidelity and Guaranty Co. v. Corning State Sav. Bank,* 154 Iowa 588, 134 N.W. 857 (1912). The *Cassidy* court reasoned that when, by virtue of fraud or *during insolvency,* a corporation accepted credit from another party, the ordinary relation of debtor and creditor

did not arise. Instead the directors of the corporation became trustees *ex maleficio* for the creditor because "title" to the money never passed. *Cassidy* declared, in effect, that the relation of trustee and *cestui que* trust came into existence, giving creditors direct rights of action against the directors of insolvent corporations, as more than one such officer, including Uhlmann, discovered in the aftermath of the Depression of 1893.

Such views as *Cassidy's* are decidedly antique. Nineteenth century courts were not always friendly to the corporate fiction, and the political atmosphere of the Populist era, particularly as it expressed itself in legislation, did little to ease that hostility. In Arkansas, for example, corporations were required to file annual financial reports in the courthouse. If they did not, directors became personally liable for all corporate debts even in the absence of reliance or misrepresentation. Kirby's Digest of 1904 § 848. *See, e.g. Hughes v. Kelley Bros.*, 95 Ark. 327, 129 S.W. 784 (1910). *See also*, "The Wingo Act," Ark. Stat. Ann. § 64-1202 (1980 Repl.)

As the corporate form and the society within which it existed matured, restrictive policies disappeared, and a more neutral view of incorporated entities became prevalent. In 1965, Arkansas passed its variant of the Model Business Corporation Act, a compendium of statutes more liberally inclined towards management than the codes which had preceeded it. The Act is this state's organic law of corporations, and governs the relations among the various interests implicated in a corporation – officers, directors, shareholders, and to some small extent creditors.

We believe, upon reviewing the Act, that it repudiates the kind of analysis which made the continuing management of an insolvent corporation tortious *per se* against creditors and investors. For example, whereas older courts may have made directors "trustees" for creditors, the Arkansas Act says: "the directors of a dissolved corporation should not be deemed to be trustees of its assets. . . . " Ark. Stat. Ann. § 64-904(A)(i). While this section of the Act ought not be interpreted expansively, we believe that it is at least expressive of a notion that corporate directors are not to be considered fiduciaries for "the world," a view towards which older cases such as *Jackson v. Lockling,* 88 U.S. 616, 624 (1874) inclined. If directors are not to be deemed trustees when a corporation is in liquidation, a process not always supervised by a court, there seems to be little support for a notion that the Arkansas common law would impose a trust on them while the business was still conducting its affairs, even though insolvent.

This is not to say that directors or third party professionals owe no duties to the shareholders or to that part of "the world" which extends business credit to a corporation. Rather, the duties owed exist independently at common law – *i.e.,* the duty not to be negligent, not to be fraudulent – and knowledge of insolvency is only *a* factor to be considered in determining the scope of the duty and the extent of the liability.

For example, in *Shapiro v. Glekel,* 380 F.Supp. 1053 (S.D. N.Y. 1974) a bankruptcy trustee brought an action against an accounting firm which had formerly been employed to audit a company's books. The trustees charged that the accountants had negligently failed to

detect inaccuracies in certain financial statements, and that the corporation was thereby allowed to overstate its earnings and financial condition, leading the directors to engage in an ill-advised series of acquisitions. The trustee claimed that the accountant's errors caused the firm to declare bankruptcy. Significantly, the accountant defendants claimed that the top officers of the company knew that the statements were inaccurate, which, they argued, should have estopped the trustee from asserting the auditors' errors as cause for damage; the defendants also argued that the corporate entity was, on the evidence, contributorily negligent as a matter of law. Such a finding, in New York law at the time would have barred recovery.

Shapiro held that the correct rule for contributory negligence applicable in accountant's liability cases is that the negligence of the employer is a defense only when it has contributed to the accountant's failure to perform his duties and to report the truth. *Id.*, at 1058. We believe that to be the correct statement of the law. While it is true that a director's knowledge may be imputed to the corporation, that rule does not apply where the director, or agent, is acting contrary to his master's interest, or in pursuit of his own. In the context where a professional auditor is retained, a law which would shield an auditor from liability in such cases would hardly encourage accountants and auditors to determine the most accurate and reliable data. The auditor's role in our society would be effectively undermined if he suffered no liabilities to his client for a negligent assay of financial statements because the knowledge of "a director" forecloses recovery. A duty to report truly and carefully should be

enforced against auditors if for no other reason than that, on the least chance, there might exist one member of a board who cared or who took his duties seriously.

It hardly speaks well of a profession that it can take a fee from an enterprise managed by persons whom it knows to be unsophisticated ("Farmer's Co-op's Board of Directors and Management Team: Do they have the capability to keep the Co-op afloat? Fred Howard – Yes. The Directors – you know *them*, what do you think? AY work papers, No. 11405 [emphasis added]) and perhaps even insouciant, and that it can defend its own negligent performance because it suggest that the directors knew that the unstated problems existed. That appears to be Arthur Young's defense. (Memorandum, August 14, 1986, pp. 9-11).

We believe that a reasonable jury could find that under the particular circumstances of this case Arthur Young's performance was negligent. Some of these circumstances are: (1) the presence of a multi-million dollar enterprise, receiving investment capital exceeding $10 million; (2) management so naive as to be the subject of deprecatory comment in the auditors' work papers; (3) a financial situation sufficiently precarious as to earn the professional sobriquet "Close Monitoring Client"; (4) a history of "related party transactions" so outrageously extreme that the principal beneficiary of Co-op "gifts," Jack White, is emboldened to demand $82,500 from the co-operative as recompense for a "contribution" he admittedly made many years ago (AY 11513); (5) the presence of a "nonproducing asset", in the form of a gasohol plant, the very existence of which is an albatross around the Co-op's neck, and the acquisition of which

was just one of a series of "related party transactions" which seemed, for some reason, solely and consistently to benefit one person. In the circumstances, the "auditors" had the choice of writing down the gasohol plant to its net realizable value, and really getting people's attention, or maintaining and even to a certain extent *inventing* a fiction that the plant belonged to the Co-op since 1979! This "hypothesis" allowed the auditors to carry the asset on the books at its cost, $4.5 million, rather than its worth, perhaps $750,000, and therefore gave the Co-op the appearance of solvency. In September, 1982, four months after this artificially roseate audit was presented, the Co-op board, not having had their attention aroused, entered a contract with Jack White to operate the gasohol plant, promising him "half the profits." Mr. White was astute enough not to make a profit from the operation of "White Flame Fuels." He sold the grain used to make gasohol, at a loss, to his new business, Valley Feeds. Valley Feeds sold the grain at a profit.

The court believes, under the rule of *Shapiro v. Glekel, supra,* that a reasonable jury would be justified in finding that the Arthur Young accountants did not proceed through their engagement as reasonable men would do. They would be entitled to find that certain damages were proximately caused by their lack of care. *Id.*, at 1058-59.

In short, although we do not believe that the operation of a business during its insolvency is *per se* negligent or wrongful, we believe that insolvency and its perception is a very important circumstance to keep in mind when one gauges the duties owed by an auditor to his client. It is a sign that says "thin ice." It will ultimately be

for the jury to decide whether the auditors behaved reasonably, in light of all the circumstances.

Context is also important in determining whether the auditors behaved recklessly. As we have said with respect to the attorneys, lawsuits do not rise or fall on the question whether a given ethical canon was observed or violated. Those canons are guides for the jury in making ultimate determinations. Similarly, auditing standards and accounting principles are helpful to a jury in determining whether the accountants comported themselves as reasonably competent professionals or whether they departed grossly from that standard. A finding of actual fraud by the jury renders an *arguable* compliance with standards moot; a *good faith* compliance with the standards, however, makes a finding of fault impossible.

In reviewing the motions for summary judgment, the court believes that a jury might reasonably find that Arthur Young's audit report was dictated by the *result* it wished to achieve, for whatever reason. Plaintiffs have suggested that the accountants did not want a reputation fro being too punctilious, or wanted to keep the Co-op's business, or maybe wanted to cover themselves for having testified on behalf of White and Kuykendall in the 1981 criminal trial. The court is uninterested in the *motive*, except to suggest that plausible ones have been advanced.

The record may permit a reasonable jury to find that the auditors adopted a blatant fiction – that the Co-op owned the entire plant at its inception in May, 1979 – in order to justify carrying the asset on its books at its total

cost, as if the Co-op had built it from scratch. The auditors indulged this fiction despite being aware of the Chancery Court decree which said that it assumed ownership of the plant in February, 1980, at a time when it was substantially completed. The auditors also had reviewed contracts and other documents showing that Jack White and Edwin Dooley jointly started the plant in May, 1979, and that White bought Dooley out six months later, taking an assignment of all of Dooley's stock. An investigation would have revealed to them that the minutes of the February 15, 1980, meeting of the Co-op board, during which the $4 million plant was allegedly "purchased," were completely silent on the point. Furthermore, audits for 1979 would never have shown that the Co-op owned the asset or claimed to have had any interest in it. A reasonable jury could conclude that the Arthur Young defendants picked an acquisition date out of the air that they could "justify," in order to record assets onto the books in a way that would make White's management "look better."

A reasonable jury could find from the evidence that when this decision was made, the cost figure given the asset was essentially invented. The Arthur Young accountants have testified that they "independently" arrived at a figure for the "cost" of the gasohol plant that matched, *to the penny,* the figure assigned by convicted felon Gene Kuykendall in his audit for White Flame Fuels. If Mr. Kuykendall had audited White Flame for 1980 in accordance with generally accepted accounting procedures and auditing standards, such a congruity of result in a similarly conducted "independent" review would not be remarkable. However Kuykendall testified

in a later deposition that he essentially "got up" a figure for White Flame overnight a few months after his conviction. He took *all* the moneys spent on the plant, and arbitrarily capitalized 80% of these and expensed the rest. Not only that, Kuykendall, realizing that snooping revenue agents might become suspicious if items were expensed at 20% across the board, cleverly juggled the figures so that certain categories of expenditure were expensed at a rate of 23%, others at 18% or 19%. He candidly admitted that expenses were figured at 20%, because otherwise the gasohol plant would have shown "a tremendous big loss" for 1980. That would not have been very pleasant for his friend, Jack White, who hung the albatross around the Co-op's neck at the end of that year.

A reasonable jury would be justified in concluding that Arthur Young did not independently arrive at Kuykendall's figure, and that the odds against their having done so were astronomical. A reasonable jury could find that Arthur Young had no actual belief in its audit report: either in the cost figure at which to record the gasohol plant or in the fiction which they employed to justify carrying the asset at cost. A reasonable jury could conclude that the determination to carry the asset at cost rather than value was critical to the presentation of the Co-op as "a going concern." A reasonable jury could conclude that a determination not to write the plant down to its "net realizable value" effectively delayed the reorganization of the Co-op for two years, and that furthermore this was a foreseeable consequence of that decision. A reasonable jury could conclude, under the

authority of *Shapiro v. Glekel, supra,* that this decision proximately resulted in damages to the Co-op.

Unlike *Shapiro,* a jury in this case could reasonably conclude that Arthur Young's conduct was fraudulent. *Ultramares Corp. v. Touche,* 255 N.Y. 170, 174 N.E. 441 (1931) held that an auditor cannot be liable in negligence to one not in privity with him, such liability groundable only in fraud. The court defined fraud for such purposes as follows: "Our holding does not emancipate accountants from the consequences of fraud. It does not relieve them if their audit has been so negligent as to justify a finding that they had no genuine belief in its adequacy . . . " *Id.*, at___. Later, in *State St. Trust Co. v. Ernst,* 278 N.Y. 104, 15 N.E. 2d 416 (1938) the same court said: "A representation certified to be true to the knowledge of the accountants *when knowledge there is none,* a reckless misstatement, or *an opinion based on grounds so flimsy as to lead to the conclusion that there was no genuine belief in its truth,* are all sufficient on which to [find fraud]." (emphasis added). The court believes, especially given the context in which Arthur Young's services were rendered, that a jury would be amply justified in finding that the accountant's audit report was a fraud on the Co-op Board, whose members have repeatedly testified that they relied on skilled professionals to give correct and reliable advice.

A finding of fraud would also enable members of the class to protest that they bought notes, or refrained from cashing theirs in, on the reasonable belief that the Co-op was solvent. However, in Arkansas, common law fraud claimants must prove that they *specifically relied* on a given representation. *CF. Higgins v. Hines,* 289 Ark. 281,

283-84, 711 S.W.2d 783, 784 (1986). The record does not permit a finding of the specific kind of reliance required by the common law precedents in this state or others. The history of the action of fraud is such that one must show that a given misrepresentation was material, and that it induced the transaction or forbearance complained of. In the *patois* of securities lawyers, fraud plaintiffs must prove "transaction causation" as well as "loss causation."

The common law of fraud has its own logic and policies, and exculpates the unscrupulous who are fortunate enough to con the extraordinarily gullible. That is, if a defendant can prove that his misrepresentation was "too outrageous" for reasonable belief, then he can defeat a common law action. *Prosser and Keeton on Torts*, 5th Ed., § 108, pp. 749-750, *citing, H. Hirschberg Optical Co. v. Michaelson*, 95 N.W. 461 (Neb. 1901).

The foregoing is set forth to demonstrate the recalcitrance of the common law of fraud and deceit to new theories in which elements such as "reliance" are capable of being presumed. In the common law world, it is still very much dog-eat-dog. We have seen no inclination from the Arkansas courts that they are willing to abandon fraud's traditional focus on the plaintiff's reasonable reliance in favor of a system of liability which seeks to deter all deceitful conduct.

As we shall have occasion to see, however, the securities laws of the state and federal governments have been drafted with a different purpose in mind, *viz.* the protection of investors. In a context in which by its very nature one parts with money, to be controlled by another, with the expectation of profit to accrue thereby, the legislatures

have shifted their focus so as to encourage full and accurate disclosure of investment information. Capital is a precious resource. Squandered, it is useless. Governments have an interest in seeing to it that legitimate and profitable businesses do not have to compete on an unfair basis with unscrupulous enterprises for the attraction of capital. Therefore disclosure laws are enacted to redress the competitive imbalance that can exist without redress under the common law. Simply put, a series of rules that emerged out of warranty two centuries ago in the case of *Pasley v. Freeman,* 100 Eng. Rep. 456 (U.B. 1789) are inappropriate for broadcasts to an extensive investor community whose responses to the same information are bound to vary according to temperment and other individual characteristics. In such a circumstance, it is only sensible, given the policies of the government to encourage a rational allocation of capital resources to shift the focus of a legal inquiry away from the many individual buyers and sellers, and onto the relatively few promoters. This shift in focus will justify the imposition of liability onto Arthur Young for violation of the securities laws, as we shall see, *infra.*

Finally, the plaintiffs have charged that there was a giant conspiracy among all or part of the defendants to maintain the Co-op through insolvency. Such a hypothesis "explains" a lot. However, there is no evidence for it. We could at greater length explain our conclusions in this regard; we believe, however, that such examinations are more appropriate in cases where plaintiffs offer *some* evidence in support of their assertions, or where they inform the court who, of all the defendants, engaged in the conspiracy. Simply stated, the charge of conspiracy

lacks any factual support. We do not think it wise to expose late arriving defendants such as Arthur Young to millions of dollars of pre-existing losses unless there is some evidence to support an inference that Arthur Young, in essence, bought into White's programme of frauds against the Co-op. If there were evidence of such an agreement, we would not hesitate to submit the matter to a jury. We are firmly convinced, under the reasoning of *Anderson v. Liberty Lobby, Inc.*, 54 U.S.L.W. 4755 (1986); *Mitsushita Electric Industrial Co. v. Zenith Radio Corp.*, 106 S.Ct. 1348 (1986); and *Fidelity Mutual Life Insurance Co. v. Price*, 180 Ark. 214 (1929), that no triable issue of conspiracy is presented under this count against any of the defendants.

Furthermore, there appears to be no issue under this count with respect to Ball and Mourton, or Carl Creekmore. The only acts alleged against Ball and Mourton relating to events happening in 1982 are that they continued representing White through his appeal and sent a single letter to an auditor. We have suggested that the letter may toll the statute with respect to earlier negligence, but we decline to find that it constitutes grounds for an entirely new cause of action. Summary judgment will be entered in favor of the lawyers and accountants on theories of conspiracy, and in favor of the lawyers with respect to allegations of fraud and negligence asserted in connection with the Co-op's operation through and beyond insolvency. Summary judgment is being denied on the Trustee's complaint that the performance of the auditors negligently or fraudulently caused damage to the Co-op.

VI. COUNT VI: ACTIONS UNDER STATE AND FEDERAL SECURITIES LAWS CLAIMS.

Defendants have moved for summary judgment on the class's state and federal securities law claims. These claims seek to hold the lawyers and the accountants liable for the sale of unregistered securities, as well as for issuing securities by means of fraudulent misrepresentations of the Co-op's financial status. We have reviewed, in our discussion of Count IV, the basic statement with which the plaintiffs take issue: that the Co-op was solvent, when in fact it had a negative net worth and a horrendously low current ratio. The plaintiffs allege further as against the Arthur Young defendants that they permitted employees of the Co-op to "condense" the audit report so as to exclude any of the accountants' explanatory notes. These notes warned, for example, that there was "some doubt as to the recoverability of the investment in the gasohol plant." It appears to be concededly true that an audit report issued without such a qualification would mislead a reader.

It appears from the record that the Arthur Young accountants met with the Co-op board to discuss their 1981 and 1982 audit reports in the spring of 1982 and 1983. They answered questions from the board, and agreed, for a fee, to address the annual meetings of the shareholders to be held a few weeks later. At these annual meetings, which were widely attended, the Arthur Young accountants were introduced to the membership as the Co-op's auditors. They then reported on the previous years' operations and presented a summary of the Co-op's assets and liabilities. These summaries did not

inform the membership that the gasohol plant was being carried on the books at cost. Instead, the members were told that a complete report was available for inspection "in the office." In addition, the Co-op mailed a monthly newsletter to its membership. This newsletter advertised the attractive rates of interest offered by the Co-op's demand note program and contained balance sheet information primitively styled "What You Own" (Assets) and "What You Owe" (Liabilities).

The information telling the Co-op member "what he owned" included the inflated cost basis report of the gasohol plant. Co-op members were continually reassured that the Co-op's million-dollar equity made investments in the demand note program "safe . . . secure . . . and there when you need it." In fact, plaintiffs say, the Co-op was deeply insolvent for nearly two years before its bankruptcy.

At the shareholders' meetings themselves, the membership were given financial statements "condensed from Arthur Young and Company's Audit Reports." These condensed reports were not qualified in any manner. They carried the gasohol plant at an expressed valuation of $4.5 million, when in fact it had a value, for scrap, between $500,000 and $750,000. The membership were advised that they had a total members' equity of $2.6 million as of the end of 1981 and $1.4 million as of the end of 1982. The court understands that a jury may find that Arthur Young's representatives simply read the condensed statements to the shareholders, without elaboration or qualification, even though the statements, without qualification, were admittedly misleading. With these matters in mind, we will proceed to study the state and

federal nonregistration and misrepresentation claims against the lawyers and accountants.

A. NON-REGISTRATION CLAIMS

The court has previously held the Co-op demand notes to be "securities" for purposes of the Arkansas securities laws requiring registration or exemption. *Robertson v. White*, 635 F. Supp. 853 (W.D. Ark. 1986). We did not then decide whether the notes were "securities" for purposes of the federal laws, but we now so hold. Our question is whether the lawyers and the accountants can be secondarily liable to the class for the Co-op's failure to register its demand note issue.

In *Stokes v. Lokken*, 644 F.2d 779 (8th Cir. 1981), the court held that a lawyer who prepared an opinion letter suggesting that sales of silver coins on margin did not constitute a securities transaction was not liable to purchasers on federal registration claims. "In a suit for damages," the court said, "liability is imposed under § 12 of the Act, 15 U.S.C. § 77(1), on persons who offer or sell securities in violation of § 5. Thus, the conduct of the alleged aider and abetter must somehow bring him within the purview of § 12, which by its very language applies only to sellers." *Id.* at 785. Liability, the court held, is limited to those in privity with the buyers and those whose participation in the buy-sell transactions is a substantial factor in its taking place.

There is no evidence at all to suggest that any of the lawyers or accountants were in privity with any of the purchasers. It does not even appear, for purposes of the federal statute, that any of the lawyers or accountants

performed any act which was a substantial factor in causing any one sale to take place, in the sense of "seduc[ing] the prey and lead[ing] it to the trap. . . . " *Pharo v. Smith*, 621 F.2d 656, 666, *on reh'g*, 625 F.2d 1226 (5th Cir. 1980). The *Pharo* court, whose opinion was cited approvingly by *Stokes v. Lokken, supra*, determined that it was necessary to show that a non-seller, or one not otherwise in privity with the buyer, was an *inducing cause* of the sale. This record falls far short of such a showing.

The question is different under the state securities act. First, liability is not limited to persons who sell or control the seller, but rather extends to specifically enumerated parties including "employees" who materially assist the sale. Ark. Stat. Ann. § 67-1256(b) (1980 Repl.). There is no suggestion that material assistance is limited to behavior which induces a sale; indeed, an argument can be made that persons of sufficient authority in the enterprise who perform ministerial acts at another's direction may be held liable for the sale of non-registered securities. Furthermore, while the list of those statutorily liable under the law would appear to be exhaustive, the statute appears to indicate that such a roster is not meant to be exclusive. Ark. Stat. Ann. § 67-1256(h) says that the rights and remedies provided by the law are in addition to those otherwise provided by law or equity. We take this to mean, in the context of a remedial statute, that if the common law were to offer a plaintiff a remedy against a person as a joint tortfeasor, who would otherwise escape liability because not an officer, director or employee materially assisting the sale, then subsection (h) should be applied to give the buyer a right and remedy against that party.

In Arkansas, all who "actively participate in committing a tort, or who command, direct, advise, encourage, aid or abet its commission, are jointly and severally liable." *Lewis v. Mays*, 208 Ark. 382, 186 S.W.2d 178 (1945). It does not appear to us that any of these defendants commanded, directed, advised or encouraged the sale of unregistered demand notes. The sales had been going on for two decades before any of these gentlemen arrived on the scene. The most that can be said is that they failed to advise against the sales. Going farther out, the suggestion is made that defendants conspired to issue demand notes in order to keep the Co-op afloat.

It is now appropriate to deal with plaintiffs' remaining conspiracy theories. We have held that "an argument can be made" that Ball and Mourton conspired with White, Creekmore, and possibly others to transfer stock of White Flame Fuels to the Co-op, and thereby involved themselves in a common law conspiracy to defraud and a conspiracy to violate the securities acts. The argument can be made because (a) it is not subject to dispute for purposes of this motion that a meeting took place on November 25 during which a plan was devised to finalize the transfer of the plant to the Co-op; and (b) that after the meeting acts in furtherance of the plan were done by each individual said to be a party to the conspiracy. As a result, the Co-op was damaged. The only dispute concerns the *animus* of the various parties: innocent, negligent, reckless or fraudulent. In that connection, we found that jury questions were made out. If a party was merely negligent, of course he couldn't be a conspirator. But a jury is entitled on the evidence to find otherwise, and, if so, entitled to find that the transfer proceeded by design.

By way of contrast, there is no evidence that these defendants conspired to sell demand notes. Certainly they knew the notes were being sold. The Co-op was selling these notes for two decades and everyone knew it. That is to say, one can hardly say that it was Mr. Ball's idea to sell the notes. Nor is there any evidence that anyone even asked him his opinion whether they should be sold. Perhaps it was "negligent" for him not to fire off a letter demanding that all sales cease; however, we doubt that. He never agreed to act for the Co-op in that capacity. Maybe it was somehow advantageous for him to acquiesce in their sale. That is, however, not the same thing as conspiring to sell them.

What evidence is there that Ball and Mourton conspired to sell demand notes? There is none. Nor is there any evidence that Arthur Young conspired to sell the notes. A tendentious argument can be made that the Co-op had to attract financing any way it could, and that the professionals realized that Jack White's mismanagement would be discovered if access to capital were closed off. This does not prove a conspiracy "clearly and convincingly" or lead a reasonable juror to "belief" in its existence. The first thing Arthur Young did was make entries reflecting demand note funds as 100% current liabilities, which drove the current rates down well below 1.0. Is one to suppose that this was done to encourage more demand note activity? Or at the behest of Creekmore? Or pursuant to a plan with Ball and Mourton? Or at White's direction? Why then was White so displeased with Arthur Young's 1981 audit? (Ex. 400). Was this merely a clever ploy to throw skeptical directors off his trail? The court is satisfied that no reasonable juror could conclude that Arthur

Young conspired with anyone to sell unregistered demand notes. The plaintiffs bear the burden of proving this assertion clearly and convincingly, and they have not done so.

Anderson v. Liberty Lobby, 54 U.S.L.W. 4755 (1986), holds that a trial court must take into account the substantive burden of proof in passing on summary judgment questions. Specifically, it says that plaintiffs must offer "concrete" proof of matters such as conspiracy, *id.* at 4759, in the absence of which a judgment should be entered against the proponent. There is nothing concrete in this record suggesting that defendants conspired to market the notes, and so they will be awarded summary judgment on that question.

Absent a conspiracy, we believe that there can be no finding of liability on the state and federal non-registration claims. The court does not believe that any of the defendants "induced" the sale of an unregistered demand note. Such a finding is apparently a prerequisite to holding a person liable under the federal statute. We do not believe that it is necessary to show inducement under the state act. However, since the lawyers and accountants are not parties primarily responsible for seeing to it that the demand notes are registered in the first place, a finding of liability under Ark. Stat. Ann. § 67-1256(a) (1) would require a greater showing of responsibility for the *illegal nature* of the sale than is shown here. Any more dilute holding would automatically require all lawyers and accountants peripherally aware of any financial activity involving a client to make uncompensated inquiries (since they were not part of the engagement) into the often complex world of securities law at the risk of being

found responsible for millions of dollars worth of rescinded transactions by plaintiffs looking for a "deep pocket." Of course, if there were evidence to show that such parties induced sales of unregistered securities, or wrongly advised primary parties not to register their offering, or "controlled" the seller, then the law might very well hold such a party responsible, either directly, or by way of contribution on a crossclaim. We say only here that at no time did Arthur Young or Ball and Mourton solicit, advise, or encourage the sale of unregistered securities, and at no time were they under any duties to run an independent assay of their clients' financial practices to assure compliance with the state and federal laws. As another court said in another context:

> To accept the SEC's position [that auditors must perform closer examinations of a related company's account balances and assets, through which all the funds for the primary entity's programs were channeled] would go far toward making the accountant both an insurer of his client's honesty and an enforcement arm of the SEC. We can understand why the SEC wishes to so conscript accountants. Its frequently late arrival on the scene of fraud and violations of securities laws almost always suggests that had it been there earlier with the accountant it would have caught the scent of wrongdoing and, after an unrelenting hunt, bagged the game. What it cannot do, the thought goes, the accountant can and should. The difficulty with this is that Congress has not enacted the conscription bill that the SEC seeks to have us fashion and fix as an interpretive gloss on the securities laws.

S.E.C. v. Arthur Young & Co., 590 F.2d 785 (9th Cir. 1979).

To hold Arkansas accountants liable under the blue sky laws simply for failing to "pick up on" a client's failure to register his securities would conscript them for the advantage of the plaintiff's bar. Absent conspiracy, we find no warrant for that. We do not find that a reasonable juror can conclude that the accountants or the lawyers knew that the corporation was selling unregistered securities; consequently, such secondary parties not being otherwise under a duty, like the directors, to find that out, we hold that they cannot be shown to be responsible for sales of unregistered securities.

B. FRAUDULENT SALES OF DEMAND NOTE SECURITIES UNDER RULE 10b-5 AND THE ARKANSAS BLUE SKY LAW

The court has had extreme difficulty parsing the class's 10b-5 complaint. We note, for example, that the 10b-5 violations are alleged to have commenced, with respect to the class, in "February 1980." (Consolidated Complaint ¶119). We gather from that allegation that plaintiffs have chosen the earliest possible date on which the gasohol plant might fraudulently have been transferred to the Co-op. If the Co-op "owned" the plant earlier than that time, the inference of fraud in the underlying transfer diminishes. The inference of later fraud becomes also less plausible. If the Co-op was an "owner" of the plant as far back as May, 1979, the inference of fraud in the underlying transfer diminishes almost entirely. It takes on, rather, the cast of a very bad deal, a foolish investment, the kind of misfortune which has so often attended parties investing in "alternative energy sources" over the past dozen years or so.

However, it cannot be the transfer of the plant, *simpliciter*, which constitutes a 10b-5 violation with respect to the class. As we explained earlier, that alleged fraud harmed the Co-op unitarily, and not its investors distributively. *See Robertson v. White*, 633 F. Supp. 854, 865 (W.D. Ark. 1986). Rather, sales of demand notes occurring *after* the transfer are the only ones infected by the bacillus of 10b-5, and then only because the Co-op, through its newsletter and other media, made statements to the public which were misleading (because incomplete) or untrue.

Our first difficulty, then, is with the "February, 1980" date. It is, in a word, imprecise. We do not have to solve the mystery of when during February the 10b-5 violations began (the first sale after the "decision" to buy the plant on February 15, 1980?) because we believe that the limitations period began later.

Briefly, the Co-op filed bankruptcy on February 23, 1984, and on February 15, 1985, Tom Robertson, the trustee, brought suit on behalf of the Co-op *and* demand noteholders, alleging 10b-5 violations, *inter alia*. Several defendants protested his standing as a class representative, *Caplin v. Marine Midland Grace Trust Co.*, 406 U.S. 416 (1972), and on May 8, 1985, the class of demand note buyers petitioned to intervene in Robertson's suit alleging class claims, including this 10b-5 action. We believe that only the class filing, and not the trustee's filing, tolls the limitation period.

First, the trustee is not now and has not ever been a member of the class. He represents, and always has, an entity hostile to the class, although he administers the

estate in their behalf. This is *not* a case such as *American Pipe and Construction Co. v. Utah*, 414 U.S. 538 (1974), or *United Airlines, Inc. v. McDonald*, 432 U.S. 385 (1977). In those cases parties who at least potentially had standing to file on behalf of a class were deemed to have tolled limitations periods for their brethren, even though the class was never certified because of numerosity questions. Fed. R. Civ. P. 23(a). Nor is this a case where the class allegations are stricken because the plaintiff, even though a member of the class, is deemed to be an inferior representative for their interests. Here, plainly and simply, on the face of the complaint, the trustee is legally disqualified from bringing an action on behalf of the class.

In this case we have no hesitance in holding that the trustee's filing did not toll the limitations period from running against the class. To permit such a filing to toll the period encourages an officiousness by interlopers we should be vigilant to check, and needlessly deprives defendants of a repose which the statute creating the right determines that they should enjoy. A *disqualification* of a class representative because of supposed *inadequacy* is premised on factual determinations which no one is presumed to know; whereas the trustee's disqualification in this case is a matter of legal standing, deducible from the complaint. Everyone is presumed to know that a trustee cannot represent creditors on their personal causes of action, as that is the law. One who acts in ignorance of the law does so at his own peril, a lesson which the trustee vividly imparted to the directors not four months ago. Thus if any class member had looked at the complaint, he would have been on notice that the

trustee's standing was questionable, and on notice to protect his own rights. But since the cases do not require or even presume reliance by passive class members, *American Pipe and Construction Co. v. Utah, supra,* at 551-553, our question becomes whether non-vigilant parties should be able to defeat a substantive right of repose given defendants because of the actions of a pure interloper. We do not believe that they should. Manifestly, in a case such as this, the court's interest in avoiding a multiplicity of actions and promoting litigational "efficiency," *American Pipe, id.* at 553, is not served by tolling the statute. Here it is the trustee's initial class suit which caused the "multiplicity." Until a proper potential class member filed, there was not even a case or controversy for us to decide with respect to the class.

Second, the trustee suggests that Carl Greul's November, 1984, securities filing in Oklahoma tolled the period for a year. This action was later voluntarily dismissed. We disagree for a number of reasons: (1) the Oklahoma filing did not name these defendants; (2) the Oklahoma complaint did not put them on notice in such a manner that, had it been amended, it would have "related back" against these defendants under Fed. R. Civ. P. 15; (3) the savings statute giving plaintiffs a year to refile the action after voluntary dismissal does not apply to statutory causes of action carrying their own special limitations periods. *See Sandusky v. First Elec. Co-op.,* 266 Ark. 588, 587 S.W.2d 37 (1979).

We decide, therefore, that the limitations period starts, at the earliest, on May 8, 1980, five years before the class filed its petition to intervene. [We borrow the limitations period in the Arkansas Securities Act, because it is

most cognate for purposes of 10b-5 questions. Also, implicitly, the Eighth Circuit recently approved borrowing limitations from a state blue sky statute in *Harris v. Union Electric Co.*, 787 F.2d 355 (8th Cir. 1986); *see also Vanderboom v. Sexton*, 460 F.2d 362, 363 (8th Cir. 1972) (borrowing Arkansas blue sky statute's limitations period for purposes of 10b-5).]

For sales of demand notes occurring after May 8, 1980, we are directed to the following series of questions: (1) whether there was a fraudulent manipulation by the Co-op or any of the defendants prior to the events of November 12, 1980 - December 19, 1980; (2) whether there was a 10b-5 manipulation occurring after November 12/December 19; and (3) the extent to which Creekmore can be liable for any sales occurring after December 31, 1980.

One thing must be kept clear: the *transfer* of the gasohol plant to the Co-op does not constitute a 10b-5 violation *vis a vis* the class. Since the Co-op received, or purchased, all of White Flame's shares, White and his confederates may be liable to the trustee under 10b-5; however, White and his confederates are not liable to the class. The court doubts that this demands much explanation, given the pains taken by the court to distinguish between corporate causes of action and shareholder causes of action in its earlier opinion. Our holding on this point, however, is not merely an application of that ruling. Rather, it proceeds from the nature of the 10b-5 cause of action itself.

10b-5 offers remedies to persons defrauded "in connection with" their decision to purchase or sell their

stock. *Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723 (1975). The problem is conceptually different, therefore, from a question whether a shareholder has a personal cause of action against a party who defrauded his company. *Blue Chip Stamps* denies 10b-5 relief to share*holders*, extending it only to parties who purchase or sell shares "in connection with" a fraud.

The class's 10b-5 claim properly concerns itself not with events leading up to the transfer of the gasohol plant to the Co-op, but with manipulations occurring afterwards to conceal the financial status of the depleted corporation. As the court is able to understand the factual issues, the "earlier on" the Co-op legitimately acquires the gasohol plant, the less materially misrepresentative are any of its statements and presentations to its membership and demand note buyers. Accountants assign different values to a fixed asset depending on whether the enterprise purchases it from another source, or constructs it on its own. If the Co-op "always owned" the gasohol plant, then its capitalization could vary significantly from a value attributable to the plant if it were purchased substantially complete and ready to produce from Jack White in February, 1980. Under the latter hypothesis, a significant part of the moneys expended by the Co-op after that date would have to be expensed.

Furthermore, if the Co-op "always owned" the gasohol plant, there would be no need, especially, for the Arthur Young accountants to procure an appraisal of the plant. But if the transaction by which the Co-op acquired the plant were a "business combination," then they may have been required still to carry the asset on the books at "cost," but with this difference: the asset would need to

be valued, and any excess of cost over market would have to be assigned as "good will." (Accounting Practices Board [APB] Opinion No. 16, ¶ 87). It is possible that Arthur Young would have had to have carried as much as $3.7 million of good will before the membership.

One can easily see the advantages to Jack White of an accounting/auditing procedure which postulated that the Co-op "always owned" the gasohol plant. What the court frankly has a good deal of difficulty understanding is Arthur Young's apparent inconsistency in treating the plant as having always been owned by the Co-op. When Harry Erwin of Arthur Young was asked about the gasohol plant by the Co-op membership during the 1982 meeting, he evaded questions about it saying that it was "a separate operation" (AY 011090) under "state law." The questions at this meeting, recorded in the minutes, appear decidedly hostile to the Co-op's management. Expenditures on legal fees and the gasohol plant were closely questioned. One can imagine just what questions would have been asked if the Co-op's members' equity were completely consumed by "good will." To most laymen in this area, "good will" means "the old folks going to the old store," a concept difficult sensibly to apply to a gasohol plant. A jury may conclude, in fact, that if Arthur Young had used an accounting treatment more in harmony with the facts, reorganization proceedings would have begun much earlier. Obviously, people buying notes after that date would not have been injured in their property. The question is whether Arthur Young's accounting treatment, which we have earlier held to be capable of being deemed at least reckless by a reasonable

jury, violates the anti-fraud provisions of state and federal law. Arthur Young argues that there can be no securities fraud liability extending to it because no one specifically relied on any of its representations concerning the financial status of the Co-op. As we mentioned, in dealing with Count IV of the complaint, this is a potent defense to any claims made under the common law. We are not convinced that this is the case under the securities laws.

I. THE ARKANSAS ANTIFRAUD SECURITIES LAWS

The Arkansas Securities Act provides:

> Civil liability – (a) Any person who
>
> (1) . . . . ,
>
> (2) offers or sells a security *by means of any untrue statement* of material fact or any omission to state a material fact necessary in order to make the statements made, in the light of circumstances under which they are made, not misleading (*the buyer not knowing of the untruth or omission*) . . . is liable to the person buying from him . . . . (emphasis added).

The court understands that the state law, by its very terms, makes "reliance" by the buyer irrelevant; instead, the seller may avoid liability by proving that the buyer knew the truth. The Uniform Securities Act, upon which this section of the Arkansas Act was almost identically modeled, does not require a showing of reliance. As the Commentary to the Uniform Act declares:

> The "by means of" clause in line 8 is not intended as a requirement that the buyer prove reliance on the untrue statement or omission. He must show only that he *did not know of it*. *See Murphy v. Cady,* 30 F. Supp. 466, 468 (D. Me. 1939), *aff'd sub nom., Cady v. Murphy,* 113 F.2d 988 (1st Cir. 1940), *cert. denied,* 311 U.S. 705, under § 12(2) of the Federal Statute.

Uniform Securities Act, Draftsmen's Commentary to § 410(a). The federal act, of course, has a limitations period of one year, instead of five, and the class did not commence its action until fifteen months after bankruptcy was declared. Thus, claims which are barred under § 12 of the Federal Securities Act of 1933, because of the passage of a year, can find a home within the Arkansas Blue Sky law, whose cognate provisions enjoy a five-year limitation period. Ark. Stat. Ann. § 67-1256(e).

The remaining question for decision is whether parties such as accountants and lawyers, who do not "control" a seller, are liable under the law. Ark. Stat. Ann. § 67-1256(b) states that "every person who controls a seller liable under subsection (a) . . . every partner, officer, director . . . every person occupying a similar status or performing [a] similar function, every employee of such seller . . . who materially aids in the sale . . . are *also* liable jointly and severally with . . . the seller . . . . " (emphasis added).

The statute gives defrauded parties not only rights against the "seller," *i.e.*, the Co-op, but also against individual directors and employees of the Co-op. It departs from the common law in this respect. Under the common law, one is not given a right of action against a corporate

director simply because the third party was tortiously injured by the corporation. *Washington Gas Light Co. v. Landsden*, 172 U.S. 534 (1899). Furthermore, a director or officer of a corporation is not liable, merely because of his official character, for the frauds or false representations of the other agents of the corporation, or for fraud attributable to the corporation itself, if such officer or director is not personally connected with the wrong and does not participate in it. *Teledyne Industries, Inc. v. Eon Corp.*, 401 F. Supp. 729 (S.D.N.Y. 1975), *aff'd*, 546 F.2d 495 (2d Cir. 1976). Of course, the rule is otherwise if the officer or director participates in the fraud – he is liable like any other joint tortfeasor.

The Arkansas Securities Act invades the common law to the extent that it enumerates parties who might not ordinarily share liability with the "seller," and imposes a statutory rescission liability against them. We do not believe that Ark. Stat. Ann. § 67-1256(b) is meant to supplant the common law, by exculpating those parties who otherwise would be liable as joint tortfeasors, or "aiders and abetters" if you will. Indeed, subsection (h) of the same statute says: "The rights and remedies provided by this act are in addition to any other rights that may exist at law or in equity."

The court believes that it would be contrary to the remedial purpose of the law to permit an active tortfeasor to escape liability in this situation. If the jury were to find that once Jack White left the Co-op in 1982, that the only persons who were aware that the Co-op was actually insolvent were the accountants and, that out of a misplaced loyalty, the accountants decided to distort the Co-op's true financial picture, knowing that people were

actively investing in the enterprise: does it "make sense" that the only parties who could be held responsible under the law were the directors, whose intent was non-fraudulent? The law would require them to prove that they did not know of the insolvency, which would mean that they would produce the audit report and claim a "good faith defense." The case against the directors would fall because they had no way of knowing (or suspecting) that accountants would perversely issue a deliberately distorted report. The accountants would claim that no common law action could be maintained against them because no one specifically relied on what they did say; although, conversely, no one would have bought a security if they knew the Co-op to be insolvent. Only if the directors failed to prove "good faith" would the accountants ever be called to court for their misdeed, because they would be liable *to the directors* in contribution. (Ark. Stat. Ann. § 67-1256(b)). The defrauded parties, under this restrictive view, could have no direct rights against the *only* parties responsible for the fraud. All of this obtains from a statute designed to "protect investors" by encouraging "full, truthful disclosure."

The court believes that the Arkansas Securities Act contemplates, through subsection (h), that parties who at common law would be jointly and severally liable with the "seller" for the sale of securities "by means of any untrue statement," should be liable under the blue sky law as well. These would include the Arthur Young accountants who breached a duty owed to the class. Under the Restatement (Second) of Torts § 876(c), a party is subject to liability to another harmed by the acts of a third party if he "gives substantial assistance to the [third

party] in accomplishing a tortious result and his own conduct, separately considered, constitutes a breach of duty to the third person." We have already discussed, *supra*, with respect to Count IV of the complaint, how the Arthur Young accountants owed a duty to the members of the class not to intentionally misstate the Co-op's financial status. The common law recognizes that duty, but holds that one may not be liable where the "victim" did not rely on the statement, or even if he did not "reasonably rely" on it. "Reliance" under the common law is a measure not of the defendant's duty, but of causation for the plaintiff's loss. Under the Restatement's test, an accountant can be held jointly liable with a seller for fraudulently misrepresenting financial information in a securities transaction.

Alternatively, the accountants can be said to exercise sufficient "control" over the seller, with respect only to the dissemination of misrepresentative material, to justify the imposition of liability under § 1256(b). "Control" is not defined by the statute. However, in *Hawkins v. Merrill Lynch*, 85 F. Supp. 104, 123 (W.D. Ark. 1949), the court noted that in the context of the federal statutes, "control" did not mean "that degree of control or the right to direct necessary to make out a common law relationship of principal-agent or employer-employee." The court believed that a more flexible meaning was intended by Congress.

We believe that the same can be said for the Arkansas blue sky law. If a third party has the power to influence the way that financial information is disseminated to the public, he exercises some measure of control over the seller and the transaction. The record shows that Arthur

Young reviewed the condensed financial statements, and perhaps in a sense approved them. The evidence tends to show that they were given proofs of the 1982 statements with notations saying that the materials were prepared from an audit report conducted by Arthur Young & Co. It would appear that at that point, certainly, Arthur Young & Co. had the "power" to protest the way in which its name was used to project materially misleading information. The court hesitates to say that this power automatically amounts to control of an issuer for all purposes; however, for the limited purpose of determining Arthur Young's ability to influence the course of dealing by the Co-op, it is not insignificant that the Co-op passed the materials on to Arthur Young "for approval" and Arthur Young chose not to exercise its prerogatives, though it certainly could have, and would have been more than justified in protesting the use of its name in that context.

We believe, therefore, that Arthur Young's motion for summary judgment on the *state* anti-fraud statutes should be denied. Plaintiffs do not have to prove reliance, and, we believe, are capable of bringing actions against responsible parties not specifically named in the statute.

We do not believe, however, that any evidence has been adduced showing Ball and Mourton to be responsible for any state securities law violations, or showing Carl Creekmore to be responsible after December 31, 1980, when he retired and ceased being, even arguably, a "controlling person." The court will grant Ball and Mourton summary judgment on these claims, and Carl Creekmore a partial summary judgment. If it appears that no demand notes were sold "by means of" an untrue statement of material fact before December 31, 1980, Carl

Creekmore can move for a verdict on the evidence with respect to those issues as well.

Defendants have also filed motions for summary judgment against the class's 10b-5 claims. We are in greater sympathy with defendants' motions under the federal laws than we are under the blue sky law. Rule 10b-5 at least arguably requires a showing of reliance missing from plaintiffs' proofs. We note, however, that the element of reliance – not mandated by the rule – has been eroded partly by the Supreme Court in *Affiliated Ute Citizens v. United States*, 406 U.S. 128 (1972), and partly by the Eighth Circuit in *Barnes v. Resource Royalties, Inc.*, No. 85-1715, CCH ¶ 92,808 (8th Cir. 1986). We believe it therefore best at this time to deny Arthur Young's motions for summary judgment under Rule 10b-5. First, the same evidence and basically the same theories will be ventilated in both the state and federal law securities claims. To the extent that there is any departure, it is in the area of damages, and we have not yet decided whether damages will be heard by the jury or by the court. (This matter was left unresolved by our October 9, 1986, pretrial.) Second, the court believes that it will be far more strategically placed to reconsider this motion at trial, when the question will be presented on a more complete record. The court confesses having some difficulty reconciling *Vervaecke v. Chiles Helder*, 578 F.2d 713 (8th Cir. 1978), with some of the more recent pronouncements from our court of appeals. It "makes sense" to the court that every misrepresentation contains within itself the seeds of an omission; and that, therefore, unless it is watched, the *Affiliated Ute* presumption will swallow all reliance requirements under Rule 10b-5. The court frankly

views cases like *Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723 (1975), as sounding an end to the expansionist notions of the securities laws expressed in *Affiliated Ute Citizens v. United States, supra*, and *Superintendent of Insurance v. Banker's Life & Casualty Co.*, 404 U.S. 6 (1971), both older cases. This concern is especially pronounced because of *Blue Chip Stamp's* reference to the appropriateness of adverting "to the tort of misrepresentation and deceit, to which a claim under Rule 10b-5 certainly has some relationship." *Ibid.* at 744. We understand the discussion following that reference to relate that transactions on an impersonal market may justify a departure from rules of earlier days. We wonder, then, in this connection, why the cases promoting a relaxation in the rule have occurred in face-to-face transactions: *Affiliated Ute* involved discrete contacts between the "market making" bankers and the Indians; *Barnes v. Resource Royalties, supra*, involved non-market transactions between a buyer and a seller. Only *Union Electric Co. v. Harris*, 787 F.2d 355 (8th Cir. 1986), concerns an omission misleading the market. Defendants question its applicability to our case because there was no "market" for Co-op demand notes: the "loss causation" in *Harris v. Union Electric, supra*, was a result of the misrepresentation and the effect of its disclosure on "the market." Here, the underlying business problems caused the loss, not the alleged misrepresentation. Arguably, the misrepresentations in this case were neither "transaction causative," or, strictly speaking, "loss causative." Rather, they merely "failed to deter" transactions. The court has a great many questions whether a representation which failed to induce a transaction should be civilly redressed under 10b-5 because it failed to deter one.

With respect to Ball and Mourton, and Carl Creekmore, the court finds no.evidence that they conspired to market the demand notes, or otherwise are liable for the violations of Rule 10b-5. Creekmore, again, will be given only a partial summary judgment, for any transactions occurring after December 31, 1980. If the facts show that no material omissions tainted sales made before that time, or if otherwise appropriate, we will entertain a later motion from him on the federal securities laws claims.

VII. COUNT XII: RICO ACTIONS AGAINST THE LAWYERS AND ACCOUNTANTS

Defendants' legal objections to plaintiffs' RICO causes of action are twofold: first, that plaintiffs cannot prove that the lawyers and accountants participated in the management or control of the Co-op, *Bennett v. Berg*, 710 F.2d 1361, 364 (8th Cir. 1983) (en banc); second, that plaintiffs cannot prove that the lawyers and accountants managed any enterprise "through a pattern" of racketeering activity. *Holmberg v. Morrissette*, No. 85-5138 (8th Cir., *slip op*. Sept. 3, 1986); *Superior Oil Co. v. Fulmer*, 785 F.2d 252 (8th Cir. 1986).

To the extent that plaintiffs base their case against Arthur Young and Co. on allegations that it participated in the operation or management of the Farmers' Co-op, they must fail. Plaintiffs have compiled an extensive record; yet, from it they are able to show just five acts by Arthur Young which they suggest support a finding of control: (a) the accountants allegedly created the Co-op's financial statements; (b) the accountants failed to obtain

client representation letters; (c) they addressed shareholder meetings; (d) they participated in the creation of condensed financial statements; and (e) the accountants helped the Co-op handle certain matters with government agencies. Perhaps the court misunderstands plaintiffs' theories in this regard, but these activities hardly bespeak the kind of "operation and management" with which we understand *Bennett v. Berg, Ibid.*, to be concerned. Plaintiffs have failed to show anything more than that the acountants reviewed a series of completed transactions, and certified the Co-op's records as fairly portraying its financial status as of a date three or four months preceeding the meetings of the directors and the shareholders at which they presented their reports. We do not hesitate to declare that such activities fail to satisfy the degree of management required by *Bennett v. Berg, Id.*

Conceding that the question of "control" is closer with respect to the lawyers Ball and Mourton, and Carl Creekmore, we nevertheless find that a RICO case has not been made out against them because plaintiffs have failed to prove that they conducted the affairs of the Co-op through a pattern of racketeering activity. In *Sedima v. Imrex*, 105 S.Ct. 3275 (1985) the Supreme Court observed in passing that the lower federal courts had failed to develop a meaningful definition of "pattern" in RICO cases, a failing, we submit, for which Congress is primarily liable, having authored the legislation without defining a critical term. That the *Sedima* court would footnote this issue, one which was not raised by the questions raised in the *certiorari* petition, nor certified by the court for review, is an indication that the court was troubled by the indiscriminate use of RICO by plaintiffs victimized by otherwise unremarkable frauds.

We are persuaded by two recent Eighth Circuit opinions that plaintiffs have failed to prove that the lawyers participated in the conduct of the Co-op through a pattern of racketeering activity. The earlier opinion of the two held that a single long-running scheme victimizing a single entity does not constitute a RICO pattern. *Superior Oil Co. v. Fulmer, supra.* The latter opinion held that multiple parties separately victimized by activities relating to a single transaction are confined to their common law remedies since a showing of activity connected with a single transaction negates a finding of a "pattern" of racketeering activity. *Holmberg v. Morrissette, supra.*

In *Superior Oil Co. v. Fulmer, supra.*, three individuals siphoned natural gas from a pipeline for refining and resale, covering up their misdeeds by posting a number of fraudulent meter readings through the mail. There was no evidence that the three committed other acts of the same tenor, or that they had ever attempted to do so. The court of appeals reversed a jury verdict finding the three liable for damages under RICO saying:

> " . . . [P]roof of a 'pattern of racketeering activity' 'requires more than one "racketeering activity" and the threat of continuing activity to be successful. It is this factor of *continuity* plus relationship which combines to produce a pattern.' . . . Superior Oil clearly has proved the 'relationship' prong. They proved several related acts of mail and wire fraud in pursuit of the underlying conversion or theft of gas from Superior Oil's interstate pipeline. . . .
>
> Superior Oil has, however, failed to prove the 'continuity' sufficient to form 'a pattern of racketeering activity'. The actions of Fulmer,

> Branch and Nichols comprised one continuing scheme to convert gas from Superior Oil's pipeline. There was no proof that Fulmer, Branch or Nichols had ever done these activities in the past and there is no proof that they were engaged in criminal activities elsewhere.
>
> Superior Oil attempted to show that Fulmer, Branch and Nichols intended to engage in similar gas conversion schemes at other locations. Although it may be that proof of a threat of continuing racketeering activities in the future could, in combination with ongoing acts of racketeering, be sufficient to establish a 'pattern of racketeering,' we find insufficient proof of such a threat here."

The *Fulmer* court, in short, agreed with *Northern Trust Bank/-O'Hare N.A. v. Inryco, Inc.*, 615 F.Supp. 828, 832 (N.D.Ill. 1985) which said that "[i]t is difficult to see how the threat of continuing activity stressed in the Senate Report could be established by a single criminal episode," noting that "[i]t places a real strain on the language to speak of a single fraudulent effort, involving several fraudulent acts, as a 'pattern of racketeering activity'."

We view *Superior Oil* as imposing a "single scheme" limitation on civil RICO cases. Where repetitive criminal activity expresses itself in a single fraudulent effort, the victim will be left to his common law fraud remedies, just as he was in pre-RICO days. We read *Superior Oil* to hold that the federal interest is ignited only when a party mounts repetitive efforts in distinct episodes.

Whatever doubts we may have entertained about *Superior Oil's* single scheme limitation were removed by the Eighth Circuit's more recent decision in *Holmberg v.*

Morrissette, supra. The court of appeals decided that the trial court erred in holding the defendant liable under RICO where the plaintiff (one of three parties each of whom was separately defrauded by the defendant,) was held to have been victimized only in connection with a single scheme, and not otherwise in connection with a pattern of racketeering activity. In *Holmberg,* three letters of credit, issued by the victims, separately secured the defendant's interest in a business transaction involving an exporter. To avoid a loss, defendant forged invoices and bills of lading to draw down the letters of credit. Even though the *Holmberg* facts (three separate acts, three different victims) differed from *Fulmer's* (one continuous siphoning, one victim), the Eighth Circuit declined to characterize this departure as material for purposes of civil RICO. The court said:

> "This court thoroughly discussed the parameters of 'pattern' in *Superior Oil Co. v. Fulmer* . . . In *Superior Oil,* we held that several related acts of mail and wire fraud as a part of a single scheme to divert natural gas . . . did not amount to a racketeering activity. There was no evidence suggesting that such activities had occurred previously or that the individuals involved were engaged in other criminal activities. . . . We believe the present case is legally indistinguishable from Superior Oil . . .
>
> . . . .
>
> We assume for purposes of our review that Holmberg proved that defendants committed acts of wire or mail fraud related to a common purpose or scheme. Our review of the record convinces us, however, that Holmberg has failed, as a matter of law, to prove the continuity

> necessary to form a 'pattern' of racketeering activity. Defendants' actions comprised one scheme to draw down the three letters of credit securing Mintex's transactions with TransWorld with respect to goods specially produced by Mintex. . . . In one sense defendants' actions were a misguided attempt to obtain payment for goods which they had produced, yet over which they had no control."

In this case, the evidence suggests that the lawyers combined to unload the gasohol plant on the Co-op. There is but one scheme. The plaintiffs' expressed theory of the case, as manifested in the Consolidated Complaint, charged all the defendants with "a [single] scheme to allow the Co-op to continue in existence, notwithstanding the depletion of its assets by looting". (Complaint ¶158). Somewhat tardily, plaintiffs suggest now that RICO case can be made against the lawyers because they twice victimized the Co-op: once to secure payment of White's legal fees, and once to transfer White's gasohol plant out of his hands.

One need only examine plaintiffs' introduction to its response to Ball and Mourton's motions for summary judgment to find expressed by plaintiffs their own view that the allegedly wrongful acts of the lawyers swung on a single pivot: the December 11, 1980, meeting of the Co-op Board. There Creekmore secured the authority to file both the declaratory judgment action, as well as a resolution authorizing the Co-op to pay the legal fees of White and Kuykendall. From that one meeting emerged a single victim (the Co-op) allegedly bilked by a single fraudulent device (fiduciaries serving masters with conflicting interests) for the direct benefit of one party (White). Collateral

benefits flowed to others, of course, but that fact is unimportant to this analysis.

The allegedly fraudulent activities in this case took place at one time and involved the same people. We do not believe that the Congress's concern that only continuing, repetitively manifested activities be redressed by RICO will be served if we indulge pleading fictions that balkanize essentially unitary transactions. The Eighth Circuit has twice clearly spoken against creative analyses of transactions that "plead defendants into RICO." A common sense view of the record seems to be clearly called-for. Where a single scheme appears, plaintiffs should be left to their common law remedies, unless the plaintiffs can show that the defendants "did it before and would do it again." In such an event, RICO manifestly has its place, and needs no artful pleading to secure it.

Even if the law allowed plaintiffs to make two schemes out of a single meeting of the Board, we believe that the payment of legal fees by the Co-op is not such a cause of action as necessarily sounds in fraud. Our view of the trustee's suit in Count I is that the gravamen of the action is one for money paid by mistake, sounding in restitution. Indeed, the cases upon which we relied in sustaining the trustee's claim acknowledged that recovery could be obtained without a showing of *scienter*. Among the theories suggested by the authorities as substantiating a claim in cases such as this one is "conversion" which, as Prosser notes, "defies definition," having its genesis in the law of trover, requiring only that plaintiff prove his right to possession and the defendant's exercise of dominion over the chattel. Prosser and Keeton, *Torts*, 5th Ed. 1984, pp. 88-90. We may at leisure

criticize the expansion of "conversion" to reach the receipt of money; however, in so doing, we note a recognition by those courts that such a claim is one which, like conversion, does not require a pronounced mental element.

We therefore believe that a pattern of corrupt management of the Co-op has not been proved. We would emphasize that "management" by the lawyers has been assumed rather than found. We do not wish to intimate that attorneys are especially prone to be found to control RICO enterprises simply by virtue of their calling. We suggest only that the question of "control" in this case is harder to reach than the question of pattern. Our findings, however, do not end our RICO inquiries, since plaintiffs have also charged that the lawyers and accountants operated their own firms as RICO enterprises, through a pattern of racketeering activity.[5]

Defendants E. J. Ball and Ken Mourton obviously participated in the management of the enterprise "Ball and Mourton." The individual Arthur Young accountants obviously participated in the management of Arthur Young. There is no proof in this record that either of these enterprises has been conducted through a pattern of racketeering activity. Rather, what we find is that to the extent that any of these lawyers' or accountants' dealings with the Co-op are wrongful, such dealings are aberrant, and in no way "typical" of the practice of these professionals.

---

[5] [Creekmore was not charged with having operated his own practice in that manner; consequently the RICO cause of action as to him is dismissed with no additional comment.]

We have mentioned our belief that the *Superior Oil* case imposed a scheme limitation on RICO. To the extent that an "outsider" directs or influences the affairs of an enterprise, we believe that RICO plaintiffs are obliged to show that he did so through a pattern of abuses. Such a pattern, we believe, cannot be found in events having a nexus to a single transaction. Such a limited showing simply does not permit a reasonable juror to conclude that the "outsider" intends to pervert the enterprise into an ongoing, continuing engine of fraud.

If the person charged under RICO is an "insider" in his own "enterprise," it is even less likely, as the *Sedima* court suggested, that two acts or schemes will suffice to prove a pattern. A person acting through the enterprise of another obviously has fewer opportunities to influence its behaviour than he does when acting through his own. This is obviously true in the cases of large law firms and accountancy firms, which will have the opportunity to "manage", loosely speaking, the affairs of hundreds and thousands of clients at a time. In a large and varied practice, a person who twice corrupts a single "outside" enterprise will more likely be found to have managed that particular enterprise through a pattern of wrongful activity, than he would his own. His "management" of the foreign enterprise may only consist of a limited number of transactions, and his readiness to exploit his association can be measured, quantitatively and qualitatively, against a much smaller range of activity. In such a case, two schemes may suffice.

When managing his own enterprise, wherein thousands of people are concerned, and many times that many transactions are implicated, it is correspondingly

harder reasonably to find a pattern of corruption arising out of only two discrete and widely separated acts. For example, if a professional service corporation were to send a single inflated bill to a client in 1973, and another to another client in 1982, it could hardly be said that it conducted its affairs through a *pattern* of racketeering activity. *Sedima v. Imrex, supra,* acknowledged the unreasonableness of finding a pattern in such activity, without holding that a pattern can never be found from a showing of two acts or schemes. The court believes that it is possible to find that an individual managed an entity through a pattern of racketeering activity if his "management" were found to consist of a sufficiently limited number of discrete acts, two of which were distinctively and separately fraudulent. Obviously, however, where one acts through his own enterprise literally thousands of times a year, it beggars sense to require him to stand trial under RICO for two overbillings occurring nine years apart.

We believe that RICO claims are most likely to be predicated on "two schemes" when a court is convinced that the schemes are *qualitatively* and quantitatively significant enough so as to permit a reasonable jury to conclude that they are somehow "characteristic" of the way a person conducts the affairs of an enterprise. If a person uses his business twice as an engine of fraud against the public in large scale securities offerings, the very distinctiveness of that behaviour may reasonably permit one to conclude that the defendant is determined to use his business as "a racket." By imposing a single scheme limitation on RICO, the courts are only forcing the statute to live up to its name. After all, any kind of

fraudulent activity above the level of Three Card Monte will involve more than two acts of mail or wire fraud. An interpretation of RICO which permits every such scheme trebly to be redressed essentially invites every fraud case to be filed in federal court. This would especially be so if, as plaintiffs suggest, RICO frauds need be proved only by a preponderance of the evidence, whereas common law frauds must be proved clearly and convincingly.

The record is devoid of proof that Ball and Mourton ever operated the affairs of Ball and Mourton so as to defraud any other party, and likewise that any of the individual accountants ever operated Arthur Young so as to defraud another. We therefore conclude that summary judgment must be entered on behalf of Ball, Mourton, Erwin, Cabannis, Drozal and Harrison. They neither controlled or managed the Co-op through a pattern of racketeering activity, nor their own firms. For these reasons as well, we dismiss Arthur Young's RICO crossclaims against the directors. Such claims, if they exist, clearly related to a single transaction or purpose, allegedly to keep the Co-op afloat.

VIII. CONCLUDING MATTERS

The remainder of the motions address allegations which have been thoroughly ventilated. For example, Ball and Mourton pray for summary judgment on Count VII which charges that they should return fees paid by the Co-op because they represented dual interests. We have already said that such an issue can be submitted to the jury as an element of other causes of action; the same is true when the trustee seeks a return of fees. It would

appear that Ball and Mourton stopped representing White in March, 1982. The court does not know whether the lawyers should be required to return fees for periods in which there was no conflict. In any event, that is an argument over "how much" not over "whether" and therefore not appropriate, we think, for summary judgment.

Similar dispositions will obtain for limitations issues, the existence of negligence questions, *etc., etc.* One must also bear in mind that damage issues, including punitive damages against these remaining defendants, have not been discussed fully, largely because they haven't been raised fully. Our decision that Ball and Mourton and Carl Creekmore performed no "acts" inimical to the Co-op after January, 1981, for example, does not foreclose the plaintiffs from proving that the Co-op suffered damages later which were proximately caused by them. We simply fail to find that these parties breached any duties owing to the various plaintiffs.

The case, we believe, is now ready for trial. Basically, the jury will be studying the events of May, 1979, to December, 1980, and in that connection will be focusing on the lawyers. A later focus will center on the events of August, 1981, to February, 1984, involving the accountants, especially with reference to damages suffered by audits presented in the spring of 1982 and 1983. Plaintiffs have not proven a conspiracy that would unite these events. One of the attractions of such theories is that they always "explain a lot." They are easy to hypothesize, harder to prove. This record offers no proof of an agreement, without which it would be plainly unjust to permit such an allegation to go to trial. We have had the occasion

to study the plaintiffs' claims that certain of these defendants are alleged to have "made up" a state of facts that allowed them to reach a result they desired. On the record presented by this case, the court would be guilty of that which the plaintiffs attack if we were to allow the jury to "make up" a scenario having no basis in the evidence simply to reach a result agreeable to the plaintiffs. We have therefore steered a course set by the polestar of *Anderson v. Liberty Lobby, Inc.*, 54 U.S.L.W. 4775 (1986), and have dismissed those claims because they utterly lack "concrete" support, and could never persuade a reasonable jury, clearly and convincingly, that such a state of facts exists.

An order will be issued contemporaneously herewith embodying these conclusions.

This 15th day of October, 1986.

/s/ H. Franklin Waters
United States District Judge

APPENDIX D

IN THE UNITED STATES DISTRICT COURT
WESTERN DISTRICT OF ARKANSAS
FORT SMITH DIVISION

THOMAS E. ROBERTSON, JR., as
Trustee of the Farmer's Co-Op
of Arkansas & Oklahoma, Inc.;
BOB REVES; FRANCES GRAHAM;
ROBERT H. GIBBS, individually;
ROBERT H. GIBBS, as natural
guardian of his minor children,
THOMAS A. GIBBS, and ROBERT H. GIBBS, JR.;
and ROBERT H. GIBBS,
as Trustee of the Muskogee
Internal Medicine Group Profit
Sharing Funds PLAINTIFFS

v. Consolidated Cases No. 85-2044,
85-2096
85-2155
85-2259

JACK E. WHITE, ET AL. DEFENDANTS

ORDER

Now on this 16th day of October, 1986, comes on to be heard defendants' motions for summary judgment. The court, on reviewing the pleadings, affidavits, depositions, exhibits, and other matters, finds:

1. That the motions of Arthur Young, and Ball and Mourton, for summary judgment on Count I are denied;

2. That the motions of Carl Creekmore, and Ball and Mourton, for summary judgment on Count II are denied, with the exception that Carl Creekmore's

plea of a bar by limitations is granted with respect to the Trustee's action for negligence;

3. That the motions of Carl Creekmore, and Ball and Mourton, for summary judgment on Count III are denied;

4. That Carl Creekmore's and Ball and Mourton's motions for summary judgment on Count IV are granted; also, that Arthur Young's motions for summary judgment on claims brought by the class in Count IV are granted; however, Arthur Young's motions against the Trustee's claims for fraud and negligence are denied;

5. Carl Creekmore's and Ball and Mourton's motions for summary judgment on Count VI are granted; Arthur Young's motions for summary judgment on Count VI are denied;

6. The motions of all defendants on Count XIII (R.I.C.O.) are granted;

7. The motions of Ball and Mourton on Counts VII and XI are denied; the motion of Carl Creekmore on Count XI is granted; the motion of Carl Creekmore on Count VII is denied;

8. The motions of separate defendant Stephen Adams are granted pursuant to Ark. Stat. Ann. § 65-117 (1980 Repl.).

IT IS SO ORDERED.

/s/ H. Franklin Waters
United States District Judge

APPENDIX E

IN THE UNITED STATES DISTRICT COURT
WESTERN DISTRICT OF ARKANSAS
FORT SMITH DIVISION

THOMAS E. ROBERTSON, JR., as
Trustee of the Farmer's Co-Op
of Arkansas & Oklahoma, Inc.;
BOB REVES; FRANCES GRAHAM;
ROBERT H. GIBBS, individually;
ROBERT H. GIBBS, as natural
guardian of his minor children,
THOMAS A. GIBBS, and ROBERT H. GIBBS, JR.;
and ROBERT H. GIBBS,
as Trustee of the Muskogee
Internal Medicine Group Profit
Sharing Funds PLAINTIFFS

v. Consolidated Cases No. 85-2044,
85-2096
85-2155
85-2259

JACK E. WHITE, ET AL. DEFENDANTS

MEMORANDUM OPINION

A. Introduction

Shortly after the jury returned its verdict in this case, the court requested that the parties make all motions for judgment notwithstanding the verdict, new trial, for credit from settlements, etc., at one time so that a definitive judgment might be entered. Although the Rules of Civil Procedure indicate that certain motions are timely only after judgment is filed, we believe that it was the wiser practice in this case to call for all motions at once,

so that appeals and distributions to the class could commence as speedily as possible. Yielding to the request of the plaintiffs, we have today entered the judgment pursuant to Rule 54(b) of the Federal Rules of Civil Procedure, so that an appeal might be immediately taken by the parties, instead of having to wait for the final disposition of the settlement approval process, the parties and claims with respect to which were severed by the court before trial. Our intent has been to apply the Rules of Civil Procedure so as to effect the "just, speedy, and inexpensive" determination of this dispute, conformably with Fed. R. Civ. P. Rule 1. Nothing we have done in this context has been intended to eventuate in any prejudice to any of the parties, and we do not think that any has occurred by happenstance. Arthur Young & Co., and Ball and Mourton, the two defendants to stand trial, have basically re-raised arguments made during the course of the pretrial proceedings in motions to dismiss and for summary judgment. Rather than recite anew the complex facts adduced in the testimony, we would refer the reader to our discussions in our opinions covering the motions to dismiss and the motions for summary judgment, which we believe represent fairly complete recitals of the evidence (certainly there were few, if any, "surprises" at trial, the witnesses having been thoroughly deposed in marathon sessions extending from January through August, 1986). Accordingly, we will now pass on the issues raised by the parties (plaintiffs filed a motion for a new trial on one of the trustee's claims against Ball and Mourton, which will be discussed in passing in the immediately following section, in which the motions of Ball and Mourton are considered.)

B. The Motions of Ball and Mourton

Defendants Ball and Mourton have asked the court for a new trial, or for a judgment notwithstanding the verdict, arguing that their motion for a directed verdict should have been granted because there was no evidence in the record that any securities of White Flame Fuels, Inc., had ever been transferred to the Co-op as a result of the declaratory judgment action. Even though we note that defendants raised no objection to the evidence on that precise ground, we are prepared to assume for purposes of discussion that such an objection was made, and we hold as a matter of law that even in the absence of a showing that *stock certificates* passed to the Co-op, a transaction subject to the securities laws was fully shown by the evidence.

First, the relevant statutes do not require proof of a sale completed in all particulars, including proof of an "execut[ion of] the stock power on the certificates at issue here." (Defendants' Brief at 8). If that were so, one could easily swindle another in a sale of stock, and avoid the securities laws simply by breaching one's contract to execute the transfer. The statutes define "sale" to *include* "every *contract of sale,* contract *to sell,* or *disposition of* a security . . . for value." 15 U.S.C. § 77(a); Ark. Stat. Ann. § 67-1247(j) (1). (emphases added). One violates the securities laws by making a fraudulent *contract to sell* a security, even if the security is withheld or otherwise not officially transferred.

The White Flame transaction obviously falls within the statutory prohibition. The term "sale" in the securities laws is not limited to technical common law sales or

transactions ordinarily governed by the commercial law of sales. *People's Bank of LaGrange v. North Carolina Nat. Bank*, 139 Ga. App. 405, 228 N.E.2d 334 (1976). Accordingly, a written commitment by a broker to deliver shares of stock was held to be a "sale" in *Lawrence v. Securities and Exchange Commission*, 398 F.2d 276, 280 (1st Cir. 1968). We believe that a chancery court decree ordering White to transfer the shares of White Flame to the Co-op satisfies the statutory requirement of a "disposition of a security for value," and find defendants' arguments to be without merit.

Ball and Mourton have also re-raised the so-called "sale of the business" defense, which we previously ruled was fully discredited by *Landreth v. Landreth Timber Co.*, 105 S. Ct. 2297 (1985). If that defense survives at all, [a matter made only slightly doubtful by ambiguous *dicta* in a footnote in a trailing case, *Gould v. Ruefenacht*, 105 S. Ct. 2308, 2311 n.2 (1985),] it would not avail defendants in this case. Here, as in *Landreth*, the seller (White) retained managerial control of White Flame Fuels after the transaction, *see SEC v. W.J. Howey Co.*, 328 U.S. 293 (1946).

More troubling, by far, than the question whether the declaratory judgment action involved a sale or other disposition of a security is whether the securities laws were meant to reach the actions of non-sellers, who come on to the scene of an arguably "done deal," and suggest a method which gives the buyer $800,000 in values (tax credits useable for 15 years) *more* than what he would have attained if he took title solely to the property or assets of the corporation rather than to its shares. The irony is, of course, that if Ball and Mourton had done nothing more than suggest that the Co-op take title to the

plant and equipment of White Flame Fuels (the economic reality of the transaction, anyway,) no securities problem would be present, and the jury's finding under Count II would have completely exculpated the defendants. The seller (White) got not one penny's worth of value *more* by parting with his securities than he would have had he parted with the plant and equipment. The buyer, the "victim" in this scenario, acquired tax credits worth nearly $800,000, as plaintiffs' expert Grabosky conceded, which it would *not* have gotten if only the plant and equipment had been transferred to it. We very reluctantly conclude that because our task is to enforce the laws as they are written, we must sustain the jury's finding because there is substantial evidence from which they could have determined that defendants substantially assisted the transaction, in bad faith or recklessly, by a preponderance of the evidence.

The defendants assert that the sale of White Flame Fuels was a "done deal" prior to Ball's initial consultation about the matter on November 25, 1980. William Moon testified that on November 11, 1980, he spoke with White at the Co-op concerning the gasohol plant. White was anxious to find a wealthy buyer or group of investors to buy it for the "tax advantages." Moon's testimony indicated that White was knowledgeable about the tax considerations involved. Certainly, this was substantial evidence that the transfer had not in fact taken place.

While it is true, as defendants argue, that the Co-op directors testified, by and large, that they had voted to buy the plant back in February, 1980, the jury was not bound to believe them. At the time that the directors were deposed, they were being sued by the trustee, and it was

then in their interest to push the date of acquisition "as far back as possible." As the defendants were able to show on cross-examination, gasohol was a "darned good idea" in 1979. A person was a "national hero," as one witness put it, if he built a gasohol plant in early 1980. As time wore on, however, such an investment got more and more "chancy." At some later point, an acquisition by the Co-op began to take on, more and more, the odor of a fraudulent white elephant foisted off onto deluded farmers. Jack White's ingenious explanations of concealed titles and hidden minutes, given in advance of everyone else's depositions, let everybody off the hook. By the time plaintiffs made their settlements with the directors, the directors were "locked into" testimony which the jury may in fact have disbelieved. They may, instead, have chosen to credit the testimony of Larry Heatherrington, a nonparty, who swore that no final action was taken at the May, 1980, meeting. The fact that some action was even contemplated in May (an assertion corroborated by Neidecker) gives the lie to a vote to buy taken earlier in February. Quite simply, the court believes that a reasonable jury could have concluded that the "done deal" never was. If, before this lawsuit was filed, one had asked directors whose memories had not been "refreshed" by White's deposition, just when the gasohol plant was bought by the Co-op, one might very likely have come up with different accounts. If one were curious as to whether White could have enforced a contract *against* the Co-op as of November 25, 1980 (certainly one index of a "done deal,") one might very well have concluded that the deal was very much up in the air, no terms, no writing, no certainty.

Because a reasonable person might conclude that there was "no done deal," it is clear that the only way that the transfer was finalized was through the chancery court lawsuit. The following evidence supports a conclusion that defendants Ball and Mourton substantially assisted the consummation of the transaction. First, they suggested the means by which the transaction might be consummated. Second, they amended the complaint to add a term absent in the first draft. (This evidence is not mere "impeachment" evidence as defendants suggest [Brief at 30], but, being an admission of a party opponent, is substantive evidence.) Finally, they presented the materials to Creekmore for presentation to the Board at its December 11, 1980, meeting. Short of manually taking the papers and the witnesses to court and personally filing the papers with the clerk, it is hard to conceive how much greater assistance could have been given. As we have said, defendants' suggestion that the White Flame *stock* be transferred, rather than its assets, was the *sine qua non* of a securities transaction. We have today expressed our reservations concerning whether securities laws were meant to reach such activities. Our reservations on this point are of the same water as those Mr. Justice Stevens expressed in his dissent in *Landreth v. Landreth Timber Co., supra*, at 2312, 2313. We have to conclude that inasmuch as the declaratory judgment action constitutes a "disposition" of a security under the broad statutory language, the assistance given to the parties by defendants Ball and Mourton was substantial. Every case must be decided on its own facts. Some securities are sold in the market, and a lawyer's involvement in such sales may well be minimal. But where shares are disposed of through the courts,

the same lawyer's involvement will likely be central. Other than remarking on the incongruities presented by the application of the securities laws to cases such as this one, we can only say that it is for the legislature to act to correct them, and not for us.

Finally, there is the question whether there is sufficient, substantial evidence of *scienter* upon which to ground liability *vis a vis* Ball and Mourton. It would be pointless to exhaustively detail all the testimony relevant to this issue given during fifteen days of trial. The jury was presented with two versions of the November 25, 1980, meeting, one of which said only White was present (Creekmore and Brewer deny having been there, Hardin and Kuykendall don't recall anyone other than White,) another which says that White was accompanied by the Board's president and its general counsel who "laid out the facts." If it were true that only White supplied the information, one might reasonably conclude that "taking White's word for it," with no investigation, constitutes an extreme departure from the standard of care exercised by a lawyer. There is other evidence in the record – the testimony of Kershen, for example, to which the jury may have given more credit than they did to that of Brill – which helped define the standard of care. The jury also observed the standard of care (coincidentally, in a securities transaction) followed by Messrs. Patton and Russell of the Friday firm, and could draw its conclusions accordingly. The court's task is not to substitute *its* opinions and judgments in place of those of the jury where there is substantial evidence in the record upon which the jury could ground its conclusion. The court believes that there is substantial evidence upon which the jury could find by

a preponderance of the evidence, conformably with the instructions, that defendants acted with the requisite *scienter*.

The court is, however, convinced that the jury erred in assessing damages in the amount of $2,732,000 as a result of the securities fraud. The court would first note the congruity between the jury's findings of damages and the plaintiffs' "damages" exhibits. The trustee claimed $1,985,000 in damages against Arthur Young, and the jury awarded precisely that amount. The class claimed $6,121,652.94 in damages against Arthur Young, and the jury awarded precisely that amount as well. The trustee claimed that if one were to assume that the securities fraud began on November 24, 1980, and continued to April 22, 1982, the Co-op lost $4,232,000. The damages found by the jury were *precisely* $1.5 million less than the total amount of damages claimed by the Trustee. Regardless how one chooses to deal with the myriad figures in this case, the correspondence is remarkable.

The court instructed the jury to find the "real value" of benefits lost by the Co-op "in connection with" the sale or "other disposition of" White Flame Fuels securities. The court does not recall any objection to that instruction from any source. This damage instruction differed from that offered under the "actual fraud" count of the complaint, which was measured by the fair market value of the rights given up by the Co-op, minus that which it received in return, to all of which was to be added any consequential damages occurring up to the time at which the fraud was or should have been discovered. Again, the court recalls no objection to this instruction from any source.

In examining the differences between the two instructions, we first note that under the securities laws instruction, we asked only that the jury determine the fair value of what the Co-op "gave up" through the declaratory judgment action, undiminished by whatever they "got in return." Under this construction, the gasohol plant was a "washout," not counted in raising or lowering the damages. The Co-op held $4.2 million of White's obligations, and he had the plant plus other personal assets with which to satisfy the guarantees. The evidence showed that if the Co-op had commenced diligent collection procedures on November 24, 1980, they would have received some but not all of the $4.2 million back. The jury was asked to determine what, if anything, they "lost" by taking the stock and cancelling the notes.

The evidence showed that *at most*, the Co-op could have liquidated $1.5 million of White's property, and would have saved an additional $250,000 that the decree ordered the Co-op to pay Citizens Bank. This is the rosiest picture imaginable for the Trustee. In all likelihood, if the Co-op sued White, he would have filed a bankruptcy, and the Citizens Bank would have shared in his estate. But no matter. The defendants put on no evidence to contradict or vary these figures, although undoubtedly appraisals done of White's property would have been much lower. One remembers that White's "financials" were prepared in order to get loans, and in such situations it is not unusual to find that people falsify information to paint a better picture of their net worth. White, in fact, was convicted in this court for doing just that nine months before the trial began.

At the very most, then, the Co-op would have gained $1.75 million by liquidating White's estate. Adding a plant valued at $1,000,000, and tax credits worth $800,000, the Co-op would have realized, theoretically, a total of $3.55 million by taking immediate action to collect and foreclose. As matters happened, the Co-op "lost," at most, $1.75 million, because they received, in return, only the plant and its credits.

Another difference between the "actual fraud" instruction and the "securities fraud" instruction was the availability of consequential damages under the former, and their absence under the latter. Consequential damages are not available under the state law claims, Ark. Stat. Ann. § 67-1256(a), and are available under Federal Rule 10b-5 claims in limited circumstances. The trustee neither pleaded nor justified a claim for consequential damages, and so the jury was not instructed to find any. Again, no one objected to the damage instruction as given.

Taking the figures given by the trustee constituting "all the losses" sustained by the Co-op from November 24, 1980, the following figures appear (Plaintiffs' Exhibit No. 1000):

1.	Jack White's net worth	$1,500,000
2.	Proceeds from sale of gasohol plant	1,000,000
3.	$250,000 paid to Citizens Bank	250,000
4.	1981 loss on gasohol plant	1,300,000
5.	1982 loss through 4/82 on gasohol plant operations	182,000
		$4,232,000

Items No. 4 and 5 *may* be recoverable in an action involving actual fraud, but not securities fraud. Item No. 2 is duplicative since the undisputed facts are that the Co-op acquired title to the plant. They "could have" gotten $1,000,000 for selling the plant because they owned it. They cannot keep the plant *and* claim damages for what they would have gotten if they had sold it. The maximum amount of damages which the Co-op can prove, then, is $1,750,000, and that is a *very* generous measure, computed on Jack White's March 1, 1981, financial statement, the credibility of which is certainly open to question.

The plaintiffs suggest that in addition to the damages listed in Exhibit 1000, there was the $200,000 or so in life insurance, etc., that the Co-op paid out to White in 1982. The argument goes that "but for" the declaratory judgment suit, the Co-op would have retained these moneys in satisfaction of the judgment they would have obtained against White. The declaratory judgment action did not require the Co-op to disburse these moneys, though. Furthermore, there is not a shred of evidence in the record that Ball *or* Mourton knew about these moneys. The Co-op disbursed these moneys in transactions separate and apart from the White Flame matter over a year later. At the very most, these damages are consequential; furthermore, they are so remote as to be not recoverable in a securities action. In any event, consequential damages must be proved to have been caused by the fraudulent transaction with a "good deal of certainty." *Zeller v. Bogue Elec. Mfg. Corp.*, 476 F.2d 795, 803 (2d Cir.), *cert. denied*, 414 U.S. 908 (1983). No such certainty attends the trustee's prayer for "business losses" and other payments to White. The Co-op essentially made a gift of its assets to

Jack White in 1982. Such an act, done a year after the transfer or other disposition of the securities, cannot reasonably be said to have been even foreseeable, much less proximately caused by Ball and Mourton.

We would also make an additional observation. The damages which the Co-op sustained from the operation of the gasohol plant would have been recoverable in an actual fraud claim, but only up to January 26, 1981. At that point, the December 19, 1980, decree was filed for public record in the Crawford County Courthouse. In Arkansas, a defrauded party is deemed to have constructive knowledge of all matters filed for public record. *Hughes v. McCann*, 13 Ark. App. 28, 678 S.W.2d 784 (1984). In addition, one's ability to recover damages for fraud is foreclosed for any period after actual or constructive discovery. *Danielson v. Skidmore*, 125 Ark. 572, 189 S.W. 57, 58 (1916). The consequential damages recoverable at common law, then, would have been those for the operation of the plant from December 19, 1980, to January 26, 1981, a little over a month. We cannot believe that the consequential damages recoverable under the securities acts would exceed those recoverable at common law, even if the proximity of the damage were otherwise proved to the jury. We do not know what losses were suffered by the plant in this five-week period, and decline to speculate. Suffice it to say that we do not believe that such consequential damages are collectable under the securities laws, and that even if we did there is no evidence that any losses were sustained during that particular period, even though losses for the gross sixteen-month period following the chancery court lawsuit were otherwise adequately shown.

In this connection, Ball and Mourton have attacked the trustee's proof of damages, asking for a new trial because the court permitted Thomas Robertson to "testify" as to that matter. The court observes first that Robertson "summarized" materials already in evidence. Exhibit 1000, introduced through Robertson, incorporated, relevantly, Exhibits 29, 102, 181 and 182. He really added nothing to the case, nor offered any opinions, not otherwise exposed to the jury in documents or witnesses as to whom and which there were no objections. If any error was made, it was doubtless harmless.

We believe, moreover, that no error was made. Thomas Robertson was no "stranger" to the suit; he was a party. As bankruptcy trustee, he came into possession (for the benefit of creditors) of all the "property of the estate" including rights of action. 11 U.S.C. § 704(3). He is not unlike an owner of the property, or the trustee of a trust, and the law liberally allows parties, owners, and trustees to testify about the "value" of property, even though they are not "experts," "appraisers," and so on. Even non-parties who have looked at property with an eye towards buying it have been allowed to express an opinion on its value. *See Chunn v. London & Lancashire Fire Ins. Co.*, 124 Ark. 327 (1916). We see no error in the proceedings and certainly no reason to order a new trial.

Finally, the trustee has asked that judgment under Count IV be amended to award the plaintiff $250,000 rather than $51,800. The argument runs that since the jury affirmatively answered the first interrogatory under that claim, they were bound to award *all* fees paid to Ball and Mourton, undisputably ranging upwards of $250,000 or so. The first interrogatory asked the jury to determine

whether Ball and Mourton "represented conflicting interests between May, 1977, and March, 1982. . . . " The plaintiff takes this question as asking, and the jury to be answering, that Ball and Mourton represented conflicting interests *at all times* between May, 1977, and March, 1982. That is not the case, however. If the court were to have asked the jury if World War II happened between 1920 and 1950, the jury could correctly answer "yes" even though the conflict began in 1939 and ended in 1945. The court additionally instructed the jury that if they found that Ball and Mourton represented conflicting interests, then they "must award a judgment based on the total amount of fees and expenses collected by Ball and Mourton from the Co-op *during the period of time* in which the conflict existed." (emphasis added). The jury could have determined that the conflict began on November 24, 1980, and ended December 19, 1980, and that Ball and Mourton did not represent conflicting interests at any other time. Of course, we do not know just when the jury found that the conflict began or ended. That circumstance moots Ball and Mourton's argument that the judgment should be amended because the fees were paid outside the period established by limitations. They bear the burden of proof on that point, and cannot establish it on this record.

Accordingly, the court will order a remittitur of $982,000 with reference to damages claimed by plaintiffs under their securities fraud claims against Ball and Mourton, or will order a new trial. If the plaintiffs accept the remittitur, judgment will be entered against Ball and Mourton in the amount of $1,801,832, subject to credits, *see, infra,* Part C.

C. The Issue of Credits Against the Verdict

Whether the verdict against Ball and Mourton (and, by analogy, against Arthur Young) should be reduced by amounts received in settlement from other defendants, is the subject of our inquiry in this section. On October 10, 1986, the court scheduled a hearing at Arthur Young's request, to determine whether the trustee and the class should be required to allocate between themselves some \$8.2 million in settlements made with them jointly by the directors and officers, and certain auditors and attorneys. At one level, the court was concerned with fairness, and used a "checkerboard" analogy to express its feeling that several plaintiffs ought not be able to sue several defendants, get a verdict, and then allocate the settlements in such a way as to artificially deny to the defendants the benefit of credits which the law would otherwise allow to them. At a deeper level, the court desired to know whether the class was to have some definable share of a fund which otherwise was escrowed to it and the trustee without differentiation. The court could foresee a possibility, for instance, that the trustee might receive no recovery, and the class a large one. If allocations were to be made after such a verdict, plaintiffs *as a whole* would be better off to allocate all settlements to the trustee. If the judgment were affirmed, the plaintiffs would reap something of a bonanza.

Such a choice would, however, throw the full weight of the risk of reversal on the shoulders of the class. If the judgment were reversed for any reason, the class would be set back on Square One. They would lose their right to a separate recovery not only from Arthur Young, but also

from those defendants, principally the directors, whom they covenanted not to sue. True enough, they would not have been total losers. The estate would have been augmented some several millions of dollars after fees and expenses were taken out, but the class would participate in the estate only as unsecured general creditors, in common with everyone else. It is unlikely that they would enjoy a "dollar for dollar" recovery, or anything near it. That would have troubled this court greatly, especially since, four months previously, we decided that certain members of the class were entitled to recover from the directors and from White an estimated $4.8 million, plus interest and attorneys' fees. Anyone can appreciate the profound due process problems which would attend an allocation skewed in favor of the trustee in that context.

The court was therefore gratified that the trustee and the class made what appears to be a fair and rational allocation. Knowing that such a decision is a hard one to make when one faces what plaintiff's counsel described as "the crapshoot" of a jury verdict, we attempted to ease the plaintiffs' fears on this point by permitting the allocation to be made after the court issued its opinion on the defendants' motions for summary judgment. Some measure of the rationality of the plaintiffs' ultimate decision on the matter of allocation is that no defendant to this point has attacked it, even though Arthur Young, certainly, had and has a motive for suggesting that the class receive more from the division. As we understand matters, the plaintiffs decided that of the $8.2 million received in settlements as of October 16, 1986, $5.6 million should go to the class and $2.6 million to the trustee.

Settlements were made with the directors and officers, auditors and attorneys (Kuykendall, Moody, Creekmore and Harriman) to extinguish, by virtue of "covenants not to sue" all common law, state and federal causes of action asserted against them, whether by the trustee, the class, or both. The state law claims included, basically, common law claims for negligence and fraud, and blue sky claims for securities violations. The federal claims embraced the securities laws, and also R.I.C.O. There is, theoretically, a possibility that two different contribution standards might apply to our question. Rather than treat that question directly and immediately, we will first address state law concerns.

Settling defendants reached an accord with plaintiffs leading to a dismissal of all common law and statutory claims against them. Of particular interest in this connection is the trustee's claims under the common law and the blue sky law against Ball and Mourton: can Ball and Mourton, who were alleged and found to have caused but a fractional part of all damages suffered by the Co-op at the hands of all the defendants, assert any right to set-off under Arkansas law? The court believes that the answer is yes.

First, the Arkansas Securities Act states explicitly that nothing in the statute is meant to abridge rights or remedies otherwise provided by law. Ark. Stat. Ann. § 67-1256(h). We conceive this to mean that if a defendant against whom a verdict is given has rights otherwise under the law to a set-off or credit for amounts otherwise taken in by settlement, then the blue sky law could incorporate those rights and procedures as well. That is, if

section 1256(h) is solace to plaintiffs, it is solace to defendants as well. Furthermore, section 1256(b) relates that contribution is available as in cases of contract. Although we recognize that, strictly speaking, a request or motion for a credit is not an action for contribution, *per se,* it is sufficiently "contribution-like" that the Uniform Contribution Among Tortfeasors Act, § 4, Ark. Stat. Ann. § 34-1004 (1962 Repl.), treats credits for settlements previously reached *in pari materia* with rules and procedures governing active contribution.

The Arkansas Contribution Act is a prolific generator of nice questions, at least in the Arkansas courts. Quite early on, the Arkansas Supreme Court expansively interpreted the term "joint tortfeasor" to embrace not only those concurrently negligent, but those who acted several months apart to contribute to the "same injury." *Applegate v. Riggall,* 229 Ark. 773, 318 S.W.2d 596 (1958). In *Applegate,* a plaintiff sued Dr. Applegate, a physician who allegedly negligently performed surgery upon her, with the result that she was ultimately required to employ Dr. Riggall to remove her kidney. Applegate denied negligence and claimed that Riggall should contribute to any judgment since Riggall had negligently come to the conclusion that the kidney required removal. Riggall demurred, claiming that he was not a "joint tortfeasor" under those facts, and the trial court agreed. The Supreme Court reversed, saying:

> Let it first be said that it is not necessary that the parties act in concert in order to be liable as joint tortfeasors, and appellee concedes this to be the general rule. *See Giem v. Williams,* 215 Ark. 705, 222 S.W.2d 800. The sole question is simply

> whether Dr. Riggall is a proper party defendant in this case. Appellee argues that the two doctors cannot be held to be joint tortfeasors, because any injuries received from either by plaintiff were separate and distinct injuries; that under the law, tortfeasors, acting independently, are jointly liable to plaintiff and liable to each other in contribution, only when the independent acts of each, cause or contribute to the same injury sustained by the plaintiff. . . . While it is true that a part of plaintiff's complaint deals with alleged injuries occurring before Dr. Riggall entered the picture, nonetheless it is apparent . . . that a substantial part of the damage complained of was allegedly caused by the loss of the kidney. In other words, the suit is based on *all* the injuries received by plaintiff. . . .

Id. at 775-76.

Arkansas appears to take the singular view that successive, independent tortfeasors are to be considered "joint tortfeasors," a matter recently noted by the Eighth Circuit in *Merrill Lynch v. First National Bank of Little Rock,* 774 F.2d 909, 916 (8th Cir. 1985). *Merrill Lynch* understands *Applegate v. Riggall, supra,* to repudiate the position taken by other courts, *viz., Lasprogata v. Qualls,* 397 A.2d 803 (Pa. 1979), that one who aggravates an earlier injury, is *not* a joint tortfeasor with a party who caused the original damage. *Id.* at 805. As a consequence of its decision, the *Lasprogata* court determined that under the law it was required to *apportion* the damages as between the two separately negligent acts, and that the rules of contribution did not apply. Having noted Arkansas' singular posture on the issue, *Merrill Lynch, supra,* applied an

expansive notion of "joint tortfeasor," (one which examines the gross injury complained of, rather than the acts which cumulatively caused it,) and held that a business which engaged in a check-kiting scheme was jointly liable with a bank, in an action in which the plaintiff claimed that the bank wrongfully chose to conceal from it information which would have led the plaintiff to discover the "kite" on its own. In examining the Arkansas precedents, the Eighth Circuit concluded that "if one tortfeasor is sued for a loss which is partly the fault of another, then he is entitled to contribution or indemnity." *Id.* at 917.

A consequence of finding that a defendant is a "joint tortfeasor" with another is that the rules of contribution come into play, one of which is that any amounts received in settlement by another tortfeasor are applied *at least* dollar-for-dollar against any verdict awarded against non-settling parties. Ark. Stat. Ann. § 34-1004 (1962 Repl.). Our case is "queer" because the trustee settled with the "deep pockets" (the directors) having the more expansive liability (one starting in 1979 and continuing into 1984, rather than, as in the case of Ball and Mourton, one commencing late in 1980 and concluding shortly afterwards in 1981,) and the greater resources for satisfying it. Such a circumstance does not in our mind justify a departure from the rule. That is, simply because one party, in the minds of the plaintiffs, has obstinately refused to contribute to a settlement fund does not mean that he forfeits all the rights the law gives to non-settling tortfeasors. Manifestly, the statute comprehends that certain defendants in multi-party cases can exploit "game theory" and ruin the day for everyone. Perhaps it would be better policy to deem them not to be "joint

tortfeasors." To reach a result which serves the "better policy" would require us to ignore *Riggall*, and the Eighth Circuit, which has so recently applied the Arkansas authority, could hardly approve of our handling of it.

There is no warrant in the statute arbitrarily to decide that the $2.6 million allocated to the trustee was for damages occurring "after" Ball and Mourton's liability concluded. Rather, the trustee settled with such parties for the Co-op's "injuries," the largest part of which included the transfer of the gasohol plant and its *sequelae*. We are confident that the trustee believed that he could recover upwards of $6 million against Ball and Mourton on his common law fraud claims. (Exhibit 1000, Part B). He failed to do so. We cannot imagine that there would have been any serious objection to crediting the $2.6 million in settlements against the $6.0 million verdict. That would clearly follow from the statute. We cannot see that plaintiff's lack of success in this particular should require the court to vary the statutory warrant to permit him a greater net recovery.

We decide, therefore, that the awards against both defendants made under the Arkansas Securities Act and common law are subject to *pro tanto* reductions; that is, that the $1.8 million verdict against Ball and Mourton, $1.75 million of which carries a statutory award of interest and attorney's fees, shall be reduced by a $2.6 million credit (at least conditionally, pending outcome of the settlement hearings before the bankruptcy court). Also, the $6.1 million class judgment against Arthur Young, plus interest and fees, shall be reduced, conditionally, by the $5.6 million taken in by the class.

The question is different with respect to the federal securities laws. Do they incorporate singular state common law contribution doctrines, ones which hold tortfeasors acting many months apart to be "joint," or do they enforce their own standards? That is, do the federal securities laws regard situations such as Ball and Mourton find themselves in to constitute an "indivisible injury," or is a federal securities violation a *distinct* injury such as requires an apportionment of settlement amounts? *See, e.g., Mackethan v. Burris, Cootes & Burris*, 545 F.2d 1388 (7th Cir. 1976), *cert. denied*, 434 U.S. 826 (1977). *Mackethan* does not solve this riddle; it merely poses it. Federal courts confronted by this teaser have repeated the old common law nostrum that "a party is entitled to but one satisfaction for a single injury. . . . " *Ratner v. Sioux Natural Gas Corp.*, 719 F.2d 801 (5th Cir. 1983). The trick, of course, is to determine whether the federal securities laws regard the events beginning in June, 1979, and continuing on through February, 1984, to be indivisible. We can only hold, consistently with our October 15, 1986, opinion on defendants' motions for summary judgment, that they do not.

The parties will recall that it was the plaintiffs' position, or at least the trustee's, that Ball and Mourton had entered a stream of fraud against the Co-op, and that under the securities laws, they were responsible not only for such out-of-pocket depletion of the Co-op's treasury as the chancery court action might have caused, but also such acts of mismanagement occurring thereafter consequential to it. We read, after some considerable study, Rule 10b-5's "in connection with the purchase or sale of a

security" requirement as divorcing acts of corporate mismanagement anterior and posterior to a securities transaction from the coverage of the statutes and the rule. Briefly, there has been "a debate" among practitioners and scholars as to whether the federal securities laws should be read to provide plaintiffs with a general warrant to search for and seize upon corporate mismanagement and breaches of fiduciary duties affecting the value of securities, and to redress them under the *aegis* of a 10b-5 action. The ultimate result of such a holding would be to construct a federal law of corporations governing all kinds of matters touching corporate governance, shareholder director and shareholder-shareholder relations. We believe that the Supreme Court, without addressing the issue *per se,* restrictively interpreted the securities laws so as to exclude from their ambit questions concerning intra corporate management. *Sante Fe Industries, Inc. v. Green,* 430 U.S. 462 (1977). Even the most zealous proponent of expansionist interpretation, William O. Douglas, writing as a commentator before he ascended the bench, described the 1933 Act as limited in its scope:

> As Berle has said, the Securities Act, though probably one of the most spectacular types of legislation, is of secondary importance in a comprehensive program of social control over finance. . . . There is nothing in the Act which would control the speculative craze of the American public, or which would eliminate wholly unsound capital structures. There is nothing in the Act which would prevent a tyrannical management from playing wide and loose with scattered minorities, or which would prevent a new pyramiding of holding companies violative of the public interest and all canons of sound finance. All the Act pretends to do

> is require the "truth about securities" at the time of issue, and to impose a penalty for failure to tell the truth. Once it is told, the matter is left to the investor.

Douglas and Bates, *The Federal Securities Act of 1933*, 43 Yale L.J. 171 (1933). As we see, the federal statutes were geared towards specific behavior and the losses which flowed to the investor from it, not towards the generality of losses that may befall the investor in securities, arising out of mismanagement or oppression.

Arkansas' tort scheme, especially when seen through the lens of *Applegate v. Riggall, supra*, emphasizes compensation far more strongly than deterrence. The Arkansas courts, in striking the balance between two principles – one, that a party receive but one satisfaction for his loss, and the other that all tortfeasors should bear a responsibility in damages for the loss which he caused, *e.g.*, Prosser, *Law of Torts*, § 50 at 307 (4th ed. 1971) – has cast the balance decidedly in favor of the former in *Riggall*. A *pro tanto* credit given to one of a number of successive, but deemed to be "joint" tortfeasors, for amounts taken by plaintiff in settlement, will distribute burdens inconsistently with the promotion of a deterrence policy.

At the same time, the deterrence goal of the federal securities laws can be overstated. If deterrence were as important to the federal scheme as plaintiffs might suggest, punitive damages would be more freely available against securities violators. *But see Meyers v. Moody*, 693 F.2d 1196, 1220 (5th Cir. 1982), *cert. denied*, 464 U.S. 920 (1983). The securities statutes from which Rule 10b-5 springs limits one to a recovery of "actual damages." Securities Exchange Act of 1934, § 28(a). Furthermore,

interest awards under 10b-5 are discretionary, *St. Louis Union Trust Co. v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 412 F. Supp. 45, 61 (E.D. Mo. 1976), *rev'd on other grounds*, 562 F.2d 1040 (8th Cir. 1977), *cert. denied*, 435 U.S. 925 (1978), as are attorney's fees. Deterrence is an important policy of the securities laws, important enough, we conclude, that a party found to have violated the law should not receive a full *pro tanto* credit from settlement amounts given for releases from claims fully embracing but far more extensive than the securities violation.

We believe, therefore, that the amounts taken in settlement should be ratably reduced so that a partial credit, although not an entire one, can be taken against the securities verdict. The jury, being deliberately kept ignorant of the amount and allocation of the settlement at plaintiffs' request, could not, of course, have assisted us in our inquiry. Had the jury been informed of the amount and allocation, presumably they could have given a verdict for any amounts above those already received in settlement, as is done in the state courts. *Giem v. Williams*, 215 Ark. 705 (1949).

The settlements with the trustee tacitly acknowledged some degree of "fault" for the Co-op's loss – at least to the extent that courts recognize that such payments are not "gratuities," a characterization which would summon application of the "collateral source rule" and deny *any* credit for amounts taken in settlement from other parties. *Snowden v. D.C. Transit System, Inc.*, 454 F.2d 1047, 1049 (4th Cir. 1976). It is not apportionment of fault with which we are concerned, but the *attribution* of a part of a larger amount paid to settle a gross injury which

includes damages wrought by all the defendants – settling and non-settling alike – as a credit against a smaller amount assessed by the jury against one actor in a chain of tortious circumstance. In federal securities cases, the court is given some discretion in this matter. *Sirota v. Solitron Devices, Inc.*, 673 F.2d 566 (2d Cir. 1982). Where the court makes an attribution of this sort, the question becomes which method to use. Manifestly, attribution serves both policies of the federal securities laws – compensation and deterrence – and is therefore superior to a *pro tanto* credit, which ill-suits the deterrent policy of the law, and to a policy allowing no credit at all, which permits a plaintiff ultimately to recover *more* than his actual damages for a securities violation. It is to be observed that in this case, assuming a remittitur is accepted, the verdict amount is the maximum possible allowable under the evidence and the instructions pronounced and agreed upon by the parties, both trustee and defendant. The 10b-5 action against Ball and Mourton was concurrently pressed against the directors, Creekmore, the auditors, and certain "inside" employees, and cannot be said to have had *no* effect in inducing them to settle as generously as they did. In fact, as far as it goes, the "blue sky/10b-5" action was practically the only one still on the board against Creekmore, although his settlement ran to both the trustee and the class, and comprehended claims in addition to those asserted for fraud and securities violations. It is impossible to judge just what effect the presence of these claims had on the decision to settle. Hindsight based on the jury's verdict would indicate that the influence may have been considerable, or should have been. But hindsight availeth us naught.

We conceive that there are at least three possible ways to perform an attribution. The first would be for the parties to have assessed a settlement amount for each claim. Ball and Mourton gave releases to Moody, for example, and in return for which they expected to get a *pro tanto* discharge from their liabilities therein. The "release" of Moody by the trustee and the class did not differentially specify the claims released and the consideration therefor, but rather discharged in gross all liabilities Moody had to the trustee and to the class. Releases not restricted to particular demands or claims ordinarily cover all claims then due. *Daniels v. Tip Top Plumbing & Heating, Inc.*, 409 S.W.2d 741 (Mo. 1966). It is certainly within the plaintiff's power to denominate what *claims* he is releasing in a multi-party case. *E.g., Swope v. General Motors Corp.*, 445 F. Supp. 1222, 1227 (E.D. Mo. 1978), and presumably for how much. If that were done, the court's task would be much easier. The amounts segregated as to *claim* could simply be applied *pro tanto* against the verdict. It is unlikely that this is a realistic alternative. Parties settle *lawsuits*, not separate claims. It would hardly promote the settlement process, for example, to encourage or require parties to allocate gross settlement amounts among negligence, warranty, or strict liability claims.

A second alternative would be to apply a *per capita* reduction of settlement amounts, and apply the balance against the verdict. For example, if five parties were involved in a securities claim and four "settled," four-fifths of their settlement amount could apply against the verdict. The argument might run that the securities statute permits "contributions as in cases of contract," which

is *per capita.* We find persuasive, however, the reasoning of *Gould v. American-Hawaiian Steamship Company,* 387 F. Supp. 163, 170 (D. Del. 1974), which declares that the Congress did not intend that aspect of contract law to take its place in securities regulation. It is also defective as applied to our case since it applies arbitrary numerators and denominators to a question of credit against a verdict, where the settlement in question was reached for claims and damages distinct from and exceeding that awarded for the securities violation. In addition, simply because a statute speaks in terms of *pro rata* contribution, it does not follow that such contribution be *per capita,* but may also bear on the amount of consideration paid. *Lahocki v. Contee Sand & Gravel, Inc.,* 398 A.2d 490, 573, *rev'd on other grounds,* 410 A.2d 1039 (Md. 1979).

A more *rational* way of dealing with this problem is to take the *total* damages suffered by the trustee as a denominator, the numerator being the verdict assessed against the non-settling defendant, and *multiply* that fraction against the amounts gathered in settlement to arrive at the credit against the verdict. The total settlement of $8.4 million has been allocated on basically a 5.6:2.6 ratio between the class.[1] After October 10, 1986, the trustee and class received a $75,000 settlement from Creekmore, and the trustee alone a $40,000 settlement from Farmland. Thus the *total* amount due the trustee alone from which an attribution might be made is $2.692 million

---

[1] Since the allocation was made, the plaintiffs settled with Creekmore, White and Brewer, but we have not included these in the ratio.

([2.6/8.2 x 8,362,000] + $40,000). Of that amount, a certain percentage is attributable to the securities violation in the White Flame transaction. In a personal injury case it might be more "daunting" to fix the proper "denominator" for our ratio: there are intangibles to consider such as pain and suffering. Here, however, the trustee showed (and the evidence justified) that the Co-op's total damages were $7.9 million (Ex. 1000) starting from 1979 and continuing through to the filing of bankruptcy. Using that as our denominator, it appears as if some $613,000 should apply against the verdict. In a case where no releases had been exchanged among the several defendants, this would be the proper computation.

There are, however, two separate kinds of releases here. The first is "straight forward" and provides that all amounts received thereunder shall apply "dollar for dollar" against the verdict. These releases, from Moody, Kuykendall, Citizens Bank, Creekmore and Harriman, and Farmland, White and Brewer, amount to $1,702,000. We have no choice but to apply the *full* amount due the trustee on the 2.6:5.6 allocation towards the verdict he received. That is, from those amounts $539,656 applies *pro tanto*.

The settlement with the directors is different. It applies a *pro tanto* reduction *only if* the verdict is tripled. The verdict, of course, was not tripled. Instead, therefore, that a ratio of the settlement apply *pro tanto* through the release, the trustee's portion of the directors' settlement should be multiplied by the ratio of verdict to total damages and applied against the securities claim. This amounts to $491,000, which, when added to the other amount produces a total credit of $1,030,656 against the

judgment. The $51,800, being a state common law claim, is reduced *pro tanto* without attribution or reduction, but only if there are "unused" credits on the securities claims. Judgment shall enter for the trustee on his 10b-5 claim in the amount of $719,344, if remittur is accepted.

Interest is discretionary in 10b-5 cases. *Huddleston v. Herman & MacLean,* 640 F.2d 534, 560 (5th Cir. 1981), *modf'd on other grounds,* 459 U.S. 375 (1983). For the following reasons, we believe that it should not be granted on the full amount of the verdict against Ball and Mourton. First, the verdict given is the maximum possible which the trustee could have gained. It assumes the truth of the following: First, that White valued his assets at "market"; second, that if the Co-op had moved against his assets starting on November 24, 1980, it would have achieved a full $1.5 million recovery. Given that White, or indeed anybody, could have litigated the question, converted non-exempt assets into exempt ones in the meantime (homestead, life insurance, etc.) and filed a bankruptcy, it is quite unlikely that the Co-op could have achieved so healthy a recovery on its notes. The damages in this 10b-5 action were not "liquidated" in other words, and the award given represents not only a generous one under the facts, but also one which probably contains a sufficient "pad" to accommodate any accumulation of interest at 6% (the Arkansas presumed rate) over the six years since the transfer. We wish to reserve the question as to the amount of attorneys' fees, if any, for later proceedings, which can run concurrently with an appeal, on application by the parties. Our court of appeals prefers to dispose of all questions at one time, and since we can foresee that time for appeal may be lengthy enough

as it is, there is no need in protracting it by a half-year contest over fees. We would ask, therefore, that an appealing party move that the question be remanded to us for work in the meantime, since we understand that an immediate notice of appeal will be filed, which might otherwise oust us of jurisdiction. We will therefore order a new trial, or reduce the jury's verdict to $1,750,000 on the 10b-5 claim, subject to a $1,030,656 credit, conditional on approval of settlements and allocations.

D. Arthur Young's Motions Against Liability Findings Under the Securities Laws

The post-verdict motions of Arthur Young & Co. assert that it should have judgment notwithstanding the verdict on both the state and federal securities laws claims for the following reasons:

(1) With respect to the state securities laws claims, Arthur Young says that the state law is modeled on section 12 of the Securities Act of 1933, and that since it could not be liable under that section, it should be absolved of liability under the cognate state law. Also, under the state law, the plaintiff, claims Arthur Young, must affirmatively prove his ignorance of the untruth or omission, and for having failed to do so, the class cannot complain. Finally, Arthur Young cannot be secondarily liable for any violation by the Co-op since it is not specifically listed as a party *prima facie* liable pursuant to Ark. Stats. Ann. § 1256(b).

(2) With respect to claims brought under Rule 10b-5, Arthur Young claims that this court

> should enter judgment in its favor notwithstanding the verdict because it either owed no duty to the class or satisfied any duty which it owed. Arthur Young claims that it made no representation to the class at large, and that no one relied on any statement made.

In addition, Arthur Young claims that rescission is an improper measure of damages to assess against one not in privity with the buyer. Also, Arthur Young claims that no judgment was entered against any individual partner, and therefore none can be entered against the partnership. Finally, Arthur Young claims that it should have been granted instructions against the directors on contribution claims, and should have a new trial to assert such claims for contribution. By separate motion, Arthur Young claims that any judgment entered against it should be reduced by the amount already paid and allocated.

We shall address the foregoing, in roughly inverse order. We believe that any judgment entered against Arthur Young in favor of the class should be reduced *pro tanto* by amounts allocated and approved. The court is impressed by one feature of plaintiffs' 17-page brief in opposition to any reduction in the verdict: it failed to cite a single authority for any of its policy arguments. By contrast, the defendants have referred us to Arkansas statutory law, Ark. Stats. Ann. § 34-1004, which calls for a *pro tanto* credit. Other authorities have approved a *pro tanto* credit in federal securities law cases in appropriate circumstances. *See, e.g., Rolf v. Blythe, Eastman, Dillon & Co., Inc.* 570 F.2d 38, 49-50 (2d Cir. 1978). We do not believe that the fact that there were other members of the

class *as approved* has any bearing on the case. It is extremely doubtful that any "patronage dividend" obligees had any individual claims against defendants which survived the April 4, 1986, ruling on motions to dismiss. Furthermore, any liabilities owed by accountants and auditors with reference to demand note buyers purchasing notes before April 22, 1981, were satisfied in documents explicitly calling for *pro tanto* reductions. In short, we can find no warrant in law - other than a "policy" argument claiming that it is desirable to "punish" non-settlers by making class members more than whole - which would justify such an unprecedented action.

With respect to Arthur Young's claim that we wrongly denied it contribution on the class claims, we note that Arthur Young did not make a specific objection at trial concerning our failure to instruct the jury with respect to contribution from the directors on those claims. Furthermore, the instruction Arthur Young has included in its brief is an incorrect statement of the law. Such an instruction (for contribution) must assert the elements of the class's claim against the party from whom contribution is sought, since one cannot obtain contribution from one against whom the plaintiff has no cause of action. *Applegate v. Riggall*, 229 Ark. 773, 318 S.W.2d 596 (1958). A correct instruction would have directed the jury to find that the Co-op sold notes by means of a materially misleading statement, and that the defendants were directors of the Co-op, *unless* the jury found that at the time of the sale the directors did not know of the misstatements and could not have known of the misstatements in the exercise of ordinary care. In addition, it is hard to conceive,

for example, that "contribution" would have any effect at all on the amount which Arthur Young must pay. Somehow the directors, who only repeated what Arthur Young found, would have to be found more than 80% responsible (assuming a total verdict of $7,000,000) before it would have any effect on Arthur Young. In any event, we find that no error was committed because of Arthur Young's failure to object to our not giving an instruction on the class claim. Arthur Young cannot complain about any failure to give "Instruction W" (which, if proffered, was not done so on Thursday, November 13, or Saturday, November 15, and was therefore waived) since that instruction manifestly misstates the law. Finally, if an error was made, a new trial need not be ordered at this time since a right of active contribution arises only after a party has *paid* more than his "fair share." We believe, moreover, that it is highly unlikely that a jury can reasonably find that the directors were *more* responsible for the misstatements, when the jury found as a fact that the fraud "originated" with Arthur Young.

With respect to Arthur Young's claim that no judgment can be entered against it unless the jury found an individual partner liable, we make the following observations: First, Mr. Matson, as counsel for Arthur Young, did not object to the form of verdicts. We believe that the record will show quite the contrary, in fact. Second, defendants did not argue that the court's instruction about the liability of partners was in error. The authorities cited by Arthur Young are inapt, all as shown by the plaintiffs in their response. Naturally, derivative liability cannot be determined in the absence of a specific, primary liability. The jury was instructed that they must find

such primary liability. Everyone understood the instructions. If Arthur Young & Co. thought that it was prejudiced by the charge to the jury, and that under the charge Arthur Young & Co. could be held liable even where the jury found no fault or breached duty by any of its partners, the court would gladly have clarified such instructions. The record may show that we, indeed, did alter our charge on several occasions at Arthur Young's request. For example, our instruction on professional negligence was amended to add the proviso that "a good faith error in judgment is not negligent." There are other examples, of course, on both sides of the case. The point is, the court stood ready to change any erroneous instruction at the request or objection of any party. Arthur Young remained silent. We even understood Mr. Matson to say that it was not necessary to enter judgment against the individual partners (clouding title to their lands) since Arthur Young was good for the loss. We believe this objection to the verdict misreads the law, and has been waived by a failure timely to object to the instructions given the jury.

Having disposed of those questions, we will now treat Arthur Young's arguments concerning the state and federal securities laws, and the propriety of rescissionary damages in a 10b-5 case against an "aider-and-abettor."

E. Arthur Young and the Arkansas Securities Act

Arthur Young argues that since Ark. Stat. Ann. § 67-1256(a) is modeled on section 12 of the Securities Act of 1933, there can be no judgment against it on state law claims since its participation in the actual sales of the notes is too slight for liability under the federal law. *See*

Stokes v. Lokken, 644 F.2d 779 (8th Cir. 1981); and *Lane v. Midwest Bankshares*, 337 F. Supp. 1200, 1209 (E.D. Ark. 1972).

The interesting aspect to this argument is that section 12 applies by its terms only to "sellers," but that broader liabilities have been implied under the Act. Arthur Young seems to have suggested that liabilities cannot be implied against parties not named as presumptively liable under the state statute. However, their argument is considerably undercut by the fact that broader liabilities are freely implied under the federal laws. If, as Arthur Young suggests, the state law is modeled on section 12 of the Securities Act of 1933, then surely there can be no impediment in the language of the statute to an implication of liability against one not named as liable by the Act. Under section 12, for example, parties have been held to be sellers even though they did not "sell" the security, or control such a seller. Thus, brokers have been deemed sellers under the Act. *Cady v. Murphey*, 113 F.2d 988 (1st Cir. 1940), *cert. denied*, 311 U.S. 705 (1941). Courts have also found section 12 liability against those who, though not sellers, brokers, or controllers, "seduced the prey and led it to the trap," but did not spring the snare. *Lennereth v. Mendenhall*, 234 F. Supp. 59, 65 (N.D. Ohio 1964). To the same effect, *see Lawler v. Gilliam*, 569 F.2d 1283, 1287-88 (4th Cir. 1978); *Junker v. Crory*, 650 F.2d 1349, 1360 (5th Cir. 1981), and cases cited. In an enforcement action the Eighth Circuit forged a test more liberal than the "point of sale" or "proximate cause" test in an unregistered securities case. *Wasson v. Securities and Exchange Commission*, 558 F.2d 879, 885-87 (1977). It determined that a *non-*

selling broker could be suspended in a section 5 proceeding because of his "extensive role in facilitating the sale, because he was made aware of questionable circumstances surrounding the transaction which should have been investigated more fully and revealed in detail to his superiors, and because his position in the flow of information made his failure to fully investigate or disclose all the more serious." *Id.* at 887. *Wasson* does little more than erect a vigorous "but for" test of participation, specifically eschewing proximate causation required by *Hill York Corp. v. American Int'l Franchises, Inc.*, 448 F.2d 680 (5th Cir. 1971). *Wasson v. S.E.C., supra*, at 885. *Stokes v. Lokken, supra*, recognizes that section 12 liability can be applied against sellers and those in privy with the purchaser, and implied against those whose participation in the buy-sell transaction is a substantial factor in causing the transaction to take place. This is a long way of saying that the federal statute permits (and has done so for nearly 50 years) liability to be implied against parties who are not "sellers," including parties who would not be specifically designated in the blue sky laws.

Interestingly, it has come to our attention that the leading commentator on the securities laws has made approving reference to the very section of the *Restatement (Second) of Torts* to which we referred in our summary judgment opinion (section 876), as a fount from which secondary liability under an "aiding and abetting" theory might spring. Loss, *Fundamentals of Securities Regulation* (1983) at 1185 n.38. Professor Loss concentrates on section 876(b) of the *Restatement*, which speaks in terms of giving "substantial assistance or encouragement" to conduct.

Arkansas has explicitly held mere "encouragement" sufficiently tortious to make one jointly liable in negligence. *Cobb v. Indian Springs, Inc.*, 258 Ark. 9 (1975). The specific subsection which we employed, section 876(c), and on the basis of which we drew our instruction to the jury, requires a far stronger showing than mere encouragement and "substantial assistance." Taken by itself, one's act of "substantial assistance" may violate no duty to anyone. We required the class to show that Arthur Young's conduct, considered alone, violated a duty owed to them. That duty was the duty to refrain from fraud. At common law, an accountant or auditor has no duty to avoid negligence in the rendition of his services to his client, but may be liable to third parties for fraud. *Ultramares v. Touche, Ross*, 255 N.Y. 170, 174 N.E. 441 (1931).

To the extent that an argument against implication might once have been made in Arkansas, it has lost its potency since the General Assembly, in 1977, repealed that part of the Securities Act which forbade courts from creating liabilities not explicitly found in the statutes. The Uniform Securities Act, upon which so much of the Arkansas Act was based, declared in section 410(h) that:

> The rights and remedies provided by this act are in addition to any other rights or remedies that may exist at law or in equity, *but this act does not create any cause of action not specified in this section or in Section (e).* (emphasis added).

The draftsmen of the Uniform Act included the italicized clause in order to check the judiciary which, federal experience showed, had rapidly evolved private remedies perhaps unforeseen at the writing of the Securities Act of 1933, and the Exchange Act of 1934. The draftsmen said:

> A provision like that in the "but" clause appears in only a few statutes. . . . It is essential under a policy designed to make the civil liabilities as specific as possible. . . . And, as stated in the official comment, the mere presence of certain specific liability provisions in a statute is no assurance that other liabilities will not be implied, either on a tort or restitution theory. . . .

Loss and Cowett, *Blue Sky Law* (1956) at 395. The Legislature, as we say, repealed the "but" clause by Acts 1977, No. 493, § 16. There is, then, no legislative impediment to the implication of liability against Arthur Young.

Those "tort and restitution" theories to which the draftsmen alluded are longstanding in the common law. *Restatement (Second) of Torts* § 876 forbids one knowingly to assist another in breaching his duty to a plaintiff, or to breach an independent duty owed the plaintiff concurrently with the activities of a primary tortfeasor. Not as relevantly as section 876, *Restatement, Restitution* § 167, would, if implied, permit a plaintiff to recover from a person who neither sold nor controlled the seller of a security, but who *knowingly received* the proceeds of a corrupt bargain. Such a theory of recovery might permit one to be found liable even in the absence of "substantial assistance," but it would seem likely that recovery would be limited to the proceeds actually received, rather than the entire proceeds of the sale, consistently with other sections of the *Restatement*.

It remains for us to determine only whether under the peculiar facts of this case the common law of Arkansas would permit one to recover the amount of his

outlay because of fraudulent statements made to one with whom the plaintiff is not in privity. Nearly two centuries ago, in *Pasley v. Freeman*, 100 Eng. Rep. 450 (1789), the English common law took the tort of deceit out of warranty and permitted one to recover for fraudulently inducing the plaintiff to contract with a third party. Arkansas law, in a widely discussed case, permits one to recover not for fraudulent inducement to contract, but for fraudulently inducing a third party to breach a duty to the plaintiff! *Hendrix v. Black*, 132 Ark. 473 (1918).

Hendrix speculated in tax titles, and acquired one for some timberland, on the strength of which he extended a license to another to log the tract. The property was denuded of timber, and the owner of the freehold sued Hendrix for the damages done to his land. The tax title taken by Hendrix, it happened, was void. The court said:

> . . . it is obvious that if the appellant had made even the most cursory examination of the records he would have learned the facts connected with this tax title. The only fair and reasonable inference . . . is that he did not wish to do so. . . . His attitude would not have been so vulnerable nor his conduct so censurable if he had contented himself simply with buying and selling tax titles. . . .

Id. at 479. This case was appealed from a chancery court, which lacked subject matter jurisdiction over simple trespass actions at law. The gravamen of the complaint had to be in fraud, as to which equity has always concurring jurisdiction, and sometimes even exclusive jurisdiction. 19 Am. Jur. *Equity* § 39.

To the extent that a representation was made, the content of which was relied upon, it was made to a third party not involved in the *Hendrix* appeal, the logger. Had the logger alone been sued at law, he could not have defended an action of trespass on his belief that he had a proper license, although such evidence would have been relevant to a determination whether he should pay a penalty. *Caney Creek Timber Co. v. Steven*, 212 Ark. 759 (1949). Seemingly, if Hendrix had merely bought and sold his tax titles, he would not have been liable for his vendee's acts. Where damage to the freehold of the true owner was plainly foreseeable, and indeed was made nearly inevitable by the grant of a restricted license, the licensor owes a correspondingly greater duty to the foreseeable plaintiff. The cited passage from the case, *supra*, makes it appear that at common law a reckless representation made to a third party, even in the absence of a fiduciary or confidential relationship between the parties involved at suit, may suffice to impose liability on the speaker. The balance of the case makes it appear as if Hendrix and the logger colluded to trespass on the plaintiff's lands, and that the case sounds not in fraud but in some other action. Prosser, however, cites the case for the general proposition that one may be injured by fraudulent representations made by the defendant to a third party, *Prosser and Keeton on Torts*, § 105 at 725 (5th ed. 1984); and, of course, the subject matter jurisdiction in the *Hendrix* trial court was totally dependent on fraud.

One can scarcely reason from *Hendrix* and its broad liability holding and argue that the jury findings in this case represent the kind of behavior the common law would fail to sanction. The jury found that the fraud

originated with Arthur Young, and, certainly Hendrix was the author of the plaintiff's misfortune. Generally speaking, in securities cases, there is no requirement that aiders and abettors must *originate* a fraud. It is sufficient that they know of a primary violation and substantially assist it. Nevertheless, the court believed that the jury should be instructed to assign liability under the Arkansas Act only on a finding of origination for two reasons. First, if the fraud originated with the Co-op, Arthur Young might be held liable for "failing to discover a fraud," and this court was not prepared to expand the auditor's duty under the state law by that token regardless of the auditor's state of mind. We do not know what motivated Arthur Young to act as it did in this case, save to say that plaintiff has suggested some plausible ones. We do know that the jury found on substantial evidence that Arthur Young originated the fraud, and we may say that it was rather obvious that Arthur Young "struggled hard" to make the Co-op appear solvent, against all available data and any reasonable characterization of it.

Second, the Arkansas Securities Act is "status-oriented" rather than "scienter-oriented." It imposes sanctions upon those who "can control" regardless whether they do. When a corporation sells a security by means of an untrue statement, control can be exercised at two points: at the decision to sell, and at the decision to advertise or to make representations about the value of the security. If Arthur Young "originates" the material statements by means of which the securities were sold, it obviously has the power to "control" the content of those statements. The court believed that if the liability portion of the state Securities Act were to be made more flexible,

it should be done in a way that places such extended liability on a party which, in a very real sense, could determine, yes or no, whether a securities violation was to occur. This is yet another way of assuring that liability would not be placed on an auditor for a "reckless" failure to detect a fraud. In a sense then, the test we devised emphasizes "intent" and "control" and therefore will be applied (and we believe was applied) only in cases which clearly merit remediation at the hands of "third parties."

Foreseeability is obviously an important factor in a common law *Hendrix* case. Hendrix, of course, did not communicate with the victim; Arthur Young did. The jury was obviously able to draw conclusions about Arthur Young's role in the 1982 shareholders meeting. As we have said, it rather appeared as if the meeting were designed to forestall inquiry that would uncover the truth, rather than for any other reason.

We believe, therefore, that nothing in the federal securities act would forbid the implication of liability against Arthur Young under the state blue sky law; that any impediment presented by the statute was removed by the legislature; that assigning liability against Arthur Young was done on a basis consistent with the notion of duty to others to be found in Arkansas common law as well as consistently with the concept of "control" emphasized in the Securities Act; and that the jury was properly instructed in consideration of these premises.

Finally, the jury could find from the evidence that the class was unaware of the truth about the Co-op's financial condition. As we shall see, *infra*, at our discussion of 10b-5 liability, the legal theory operating in this case is

that Arthur Young committed fraud by failing to tell the directors and the class of certain facts. How can one "prove" that he didn't know of an *omission* to tell him something – or more to the point, *why should he have to* prove that he didn't know of the existence of a fact which was effectively concealed from him. What "good" would it have done if 50 or 100 members of the class took the stand? That would only mean that 1400 or so persons "failed in their proof." Burdens of proof have to be sensibly assigned, and there is no use in requiring thousands of people to "prove a negative," particularly where "common sense" tells one that some few investors would have closed their accounts down if they'd known that the Co-op was insolvent. We shall therefore affirm the verdict of the jury under the Arkansas Securities Act in all particulars.

F. The 10b-5 Claims Against Arthur Young

Arthur Young argues that as a matter of law, and on theevidence, the jury's verdict on the class's 10b-5 claim cannot stand. The class complained that Arthur Young failed to disclose certain information necessary to make its statements not misleading. Arthur Young counters that it owed no duty to the class, and that it can therefore not be held liable for failing to disclose anything to it. In support of its position, Arthur Young cites "insider" cases: *Chiarella v. United States*, 445 U.S. 222 (1980); *Dirks v. S.E.C.*, 463 U.S. 646 (1983); and *Laventhall v. General Dynamics Corp.*, 704 F.2d 407 (8th Cir.), *cert. denied*, 464 U.S. 846 (1983).

These cases control situations in which an investor, armed with material inside information, is liable to a seller for failing to disclose that information before buying stock on the market. In *Chiarella, supra,* the Supreme Court reversed and dismissed a criminal conviction against a print shop employee who had learned from documents that he was preparing that a merger was soon to take place. He bought shares in the target company and made a hefty profit. He did not disclose this information to sellers, and was indicted, as a consequence, for a fraudulent trading practice. The Supreme Court held that the mere fact that one trades on inside information, *simpliciter,* is not a sufficient basis for a criminal securities fraud prosecution; rather, the court held that there must be an independent duty at common law to disclose the information to the seller, and a breach of that duty, before it can be said that a party has violated the securities laws.

As we know, at common law, a buyer is not generally obliged to inform a seller that he is extending "too good a deal," Black, *Rescission and Cancellation* § 66 at 153 (1916), or to disclose to the seller inside information known only to the buyer which allows him substantially to profit from the seller's ignorant condition. *Laidlaw v. Organ,* 2 Wheat. 178, 4 L. Ed. 214 (1817); *Guaranty Safe Deposit Co. v. Liebold,* 208 Pa. 399, 56 A. 951 (1904). Even where the buyer was aware of "intrinsic" facts relating to the value of the property to be sold, of which the seller was ignorant, the law has denied relief. *Goodwin v. Agassiz,* 283 Mass. 358, 186 N.E. 659 (1933). There the court observed: "The law in its sanctions is not co-extensive with morality. It cannot undertake to put all parties to every contract on an equality as to knowledge, experience, skill, and

shrewdness. The action was one for rescission and rescission was denied." Of course, the rule is different where the buyer owes the seller a fiduciary duty to disclose all relevant information, or otherwise stands in a confidential relationship to him.

It was in reference to this old and settled body of law that the *Chiarella* court held that absent a fiduciary relationship, a buyer has no duty to communicate material inside information which he has gathered on his own. Similarly, in *Dirks v. S.E.C., supra,* the Court decided that an investment adviser who discovered a fraud by dint of his own efforts was not to be censured for advising his clients to sell their stock in the company. The Court emphasized that even though the adviser had gained his information from "insiders," they did not stand to gain from the disclosure. Furthermore, the tippers received no monetary or personal benefit for revealing the company's secrets, nor intended to make a gift of corporate assets to the adviser by informing him of circumstances corroborating his suspicions of fraud. Since there was no "insider liability" in such a context, the Court found that there could be no derivative liability on the part of Dirks for communicating his knowledge.

A relationship of trust and confidence may in certain cases be said to exist between a corporation and its shareholders. In such cases, courts have granted sellers remedies when the corporation, or its tippee, exploited "inside" information to derive an unfair advantage in a purchase. *Laventhall v. General Dynamics, supra,* held only that a corporation owed no duty to inform the holder of an *option* to buy the corporation's stock that it intended to declare a healthy dividend and split its stock. The court

decided that the fiduciary duties running from a corporation to its shareholders do not run to option holders, since the corporation's business is not run for such persons' benefit.

We do not believe that these cases control the issue before us. We do not think that the jury imposed liability on Arthur Young because of a supposed fiduciary *status*, but because of its affirmative acts. In this connection, language from the cited cases indirectly supports the plaintiffs' contentions. In *Dirks v. S.E.C., supra*, for example, the Court speaks not only of a breach of a fiduciary duty to speak, but breach of *any* "common law" duty. *Id.* at 653. At common law, in the absence of a fiduciary duty, a seller ordinarily can make as hard a bargain as he wishes, and incurs no liability for failing to enlighten the vendor. The case is otherwise where the buyer *knows* that the seller is laboring under a mistake. Williston, *Contracts* § 1548 n.47 and § 1557 n.89 (1920). In such cases, the common law may impose liability for failure to disclose the advantage. This doctrine is implicit even in hornbook cases denying relief to defrauded sellers. *Wood v. Boynton*, 64 Wis. 265, 25 N.W. 42 (1885) (no evidence jeweler *knew* the stone to be a diamond rather than a topaz; rescission denied). Mistake, in such contexts, is deemed to be something other than a lack of full information, else the exception would swallow the rule.

If, therefore, the common law imposes a duty on Arthur Young not to broadcast statements misleading because incomplete, then liability can be found under section 10b-5 even though no fiduciary relationship exists between Arthur Young and the class. There can be no question but that once a party chooses to speak, even

though he has no duty to do so, he assumes the duty not to speak fraudulently. Prosser & Keeton, *Law of Torts*, § 106 at 736-37 (5th ed. 1984), says:

> The representation which will serve as a basis for an action of deceit . . . usually consists of oral or written words. . . .
>
> The significance to be assigned to such words or conduct will be determined according to the effect they would produce . . . upon the ordinary mind. Ambiguous statements, which are reasonably capable of both a true and a false meaning, will amount to a misrepresentation if the false meaning is accepted, and is intended. . . . Likewise, misrepresentations may be found in statements which are literally true, but which create a false impression in the mind of the hearer, as is sometimes the case where a complicated financial statement is issued by a seller of securities. . . .
>
> In addition to such representations . . . deceit . . . may be based on an active concealment of the truth. Any words . . . which create a false impression covering up the truth, or which remove an opportunity that might otherwise have led to the discovery of a material fact . . . even a false denial of knowledge by one in possession of the facts – are classed as misrepresentation, no less than a verbal assurance that the fact is not true.

The common law forbids one to broadcast fraudulent information, or information subject to a "mental reservation" on the part of the speaker. In this case, the jury could believe that Arthur Young knew that the Co-op was insolvent "on the books." The auditors declared a false

value for the Co-op's assets, having an unexpressed "mental reservation" that the statement was "true" by virtue of a series of tenuous assumptions concluding in a finding that the Co-op always owned the gasohol plant, and could therefore carry it as a fixed asset at cost, rather than at value, with the balance accounted to "good will." APB 16.

The absence of a fiduciary relationship between Arthur Young and the class is simply a straw man. Arthur Young chose to speak, and the jury found that Arthur Young spoke falsely. Under Rule 10b-5, when a party undertakes to disclose anything, it has the duty to speak the full truth. *Cf. First Virginia Bankshares v. Benson*, 559 F.2d 1307, 1317 (5th Cir. 1977), *cert. denied*, 435 U.S. 952 (1978). That duty derives from common law, irrespective of relationship. *Restatement (Second) of Torts* § 551(2)(b) comment g (1976).

Arthur Young also claims that regardless whether it spoke falsely or not, the class cannot recover because there was no evidence that any member of the class *relied* on any representation made by the auditors and partners. The plaintiffs answer this contention by claiming that reliance is presumed in cases of nondisclosure, citing *Affiliated Ute Citizens of Utah v. United States*, 406 U.S. 128 (1972). (*See also Mills v. Electric Auto-Lite Co.*, 396 U.S. 375, 384-85 (1970), a Rule 14a-9 case.)

We have had prior occasion to express our doubt concerning whether Arthur Young was guilty of a misrepresentation, or of an omission. (Summary Judgment Opinion, Oct. 15, 1986, at 104). It appears that where one fraudulently misstates a fact, a buyer must rely on the

truth of his statement, in the absence of which his action may not proceed. If the declarant *omits* to state a fact, there can, of course, be no reliance on an omission, and the buyer is accorded a rebuttable presumption of reliance, providing that the omission is sufficiently material to influence the reasonably prudent investor. Our concern was that at a very basic level, every "lie" omits to state the truth, and by using a sufficiently lively imagination, a plaintiff can shift the burden on an important element of the common law of deceit by so characterizing a statement made by a defendant. Rule 10b-5 would be therefore transformed into a scheme of "investment insurance."

This court is troubled by the conflict in our circuit between *Vervaecke v. Chiles, Heider & Co.*, 578 F.2d 713 (8th Cir. 1978), which reads *Affiliated Ute, supra,* narrowly, and the recent cases of *Barnes v. Resource Royalties, Inc.*, 795 F.2d 1359 (8th Cir. 1986), and *Harris v. Union Electric Co.*, 787 F.2d 355 (8th Cir. 1986), which read it broadly. *Vervaecke, supra,* set forth a workable rule which declared that where a defendant actually made a statement, such a statement must be found to have induced reliance. Under the *Vervaecke* rule, class members would presumably be required to assert that they depended on the precise valuation given the Co-op's assets. That is the chief defect of *Vervaecke:* it appears to require specific reliance in contexts where motivations are complex. Unfortunately, the report in *Vervaecke* failed ever to disclose what it is that the defendants were alleged to have said, or to have omitted. It is impossible to determine whether the statements were even material. It is therefore difficult to apply *Vervaecke* by analogy.

On the other hand, *Barnes v. Resource Royalties, Inc.*, and *Harris v. Union Electric Co., supra*, appear to presume reliance even where the plaintiff has pleaded specific reliance, and given evidence on the point. The references to "presumed reliance" appear to be merely gratuitous. For example, in *Barnes* the plaintiff complained that he had been fraudulently induced to buy stock in Resource Royalties, Inc., because he understood that the company was going to develop new products. Somewhat later he learned (a) that the stock had not been sold by Resource Royalties, Inc., but by a party named McPherson, (b) consequently, none of his money was received by Resource Royalties, Inc., and (c) the company was not developing any new products. The trial court found that the buyer "repeatedly testified that he did not care who sold the securities or even what corporate entity he was investing in; plaintiff simply wanted 'a piece of the action.' " *Barnes v. Resource Royalties, Inc.*, 610 F. Supp. 499, 504 (E.D. Mo. 1985) (decision below). If the buyer did not care from whom he bought the Resource Royalties stock, then it scarcely could matter that his money did not end up in the corporate treasury. After all, blue chip stocks are bought and sold in the millions of shares every day, and no one supposes that after the initial issue money rolls into the treasury of the issuer from subsequent sales by traders. Nevertheless, the court of appeals reversed the trial court in *Barnes v. Resource Royalties*, 795 F.2d at 1367, saying:

> Although the district court discussed some rebuttable [sic] evidence, its discussion only addressed the misrepresentation that the McPhersons were sellers. That evidence did not address the alleged failure to disclose that the

> money Barnes paid for his Resource Royalties shares was never invested in Resource Royalties and never used to develop new products.

Because of this omission, the court decided that "The failure to disclose that the money was not invested in these corporations, and therefore not used to develop new products, is sufficient to raise the presumption of reliance." *Id.*

In *Harris v. Union Electric Co., supra,* the plaintiffs argued that the prospectus was misleading. The purchasers of the bonds thought that they were buying bonds with a ten-year protection from a call by the company. Union Electric argued that the bonds themselves *and* the prospectus revealed that it would call bonds before ten years if the funds to do so came from the Improvement and Maintenance Fund. The court of appeals admitted that both parties' interpretation of the prospectus was "plausible." *Id.* at 364. It should have been relatively easy, under *Vervaecke,* for bond buyers to stand, yea or nay, on whether they relied on the particular interpretation favorable to them in deciding whether to buy the bonds. They did not have to do so, however, since both the trial and the appellate court placed the onus on the seller to declare his intention. The court said:

> Reliance is established when the plaintiff shows that he was induced to act differently than he otherwise would have in making his investment decision. *St. Louis Union Trust Co. v. Merrill Lynch, Pierce, Fenner & Smith, Inc.,* 562 F.2d at 1048 (1977). Because the plaintiffs' complaint consists primarily of allegations of a failure to adequately disclose the call-protection rights,

reliance in this case can be inferred from materiality.

Both *Barnes* and *Harris*, then, significantly cut into *Vervaecke's* limitation on *Affiliated Ute Citizens v. United States, supra. Vervaecke* declared that *Affiliated Ute* did not apply in cases where statements were "actually made" because "where the securities fraud at issue closely resembles the tort of deceit, the plaintiff encounters no special difficulty in attempting to demonstrate reliance. The lack of any barrier to proof permits the private action adequately to serve its dual purposes. . . . " *Vervaecke v. Chiles, Heider & Co., Inc.*, 578 F.2d at 717, citing Note, *The Reliance Requirement in Private Actions Under SEC Rule 10b-5*, 88 Harv. L. Rev. 584, 589 (1975).

We strongly suspect that *Barnes* and *Harris* implicitly overrule *Vervaecke*, and permit the plaintiff to characterize the case as he pleases. As we have previously said, every affirmative misrepresentation contains within it the seeds of omission. Other circuits recognize that the labels themselves are of little help. *Wilson v. Comtech Telecommunications Corp.*, 648 F.2d 88, 93 (2d Cir. 1981). The distinction between an active "misrepresentation" and an "omission" is recognized as fuzzy at best. *Little v. First California Co.*, 532 F.2d 1302, 1304 n.4 (9th Cir. 1976). Our problem is compounded by the fact that neither *Barnes* nor *Harris* even mentioned *Vervaecke* and its applicability to the problem even though all three cases seemed to turn on it.

A deep reading of the cases convinces this court that it is an utterly feckless exercise to apply *Vervaecke* so long as any plausible case can be made for the following proposition: that if the plaintiff had known of a given

fact, his decision would have been different. If that proposition is read into the cases, the holdings can be harmonized. At that point, the burden-shifting mechanism of presumed reliance makes more sense. First, in an individual case, requiring one to prove a speculative negative (I-would-not-have-bought-if-I-had-known) inevitably leads to *pro forma* recitations, self-serving, tedious, and drawn-out, addressed to possibilities in the context of a decision made in an environment where motivation is complex and difficult to determine. *Affiliated Ute Citizens v. United States,* and, to an extent, *Mills v. Electric Auto-Lite Co., supra,* were both concerned that such evidence be considered unnecessary.

In a class action, the rationale applies *a fortiori.* Once the emphasis is placed on the state of mind of the many plaintiffs (reliance) instead of the few defendants (*scienter*) the whole rationale for class actions in securities cases disappears because the *common* questions of fact and law will cease to preponderate. Fed. R. Civ. P. 23a(2), b(3). Such an emphasis, furthermore, threatens to defeat valid claims. Implicit in *Affiliated Ute* is a rejection of the burden because it leads to underinclusive recoveries and threatens enforcement of the securities laws. Note, *Reliance Requirement in Private Actions Under SEC Rule 10b-5, supra,* at 590-91.

In any and all events, Arthur Young & Co. invited the omissions characterization, and is in the least appealing position to invoke the *Vervaecke* protections. Arthur Young faced an action by the trustee for negligence, and one by the class for fraud. Arthur Young stood to defeat both actions by showing that it had faithfully discharged its engagement by complying with Generally Accepted

Accounting Principles and Generally Accepted Auditing Standards (GAAPs and GAASs) consistently applied. In its opening statement, Arthur Young defended its valuation of the gasohol plant by invoking "the economic realities test." It suggested that the passage of title to the plant was shrouded in confusion, and that since all moneys for its development originated from the Co-op, inconsistent data concerning title could be ignored and "the economic realities" invoked to declare the Co-op the owner of the plant *ab initio*; therefore justifying the inflated valuation of the plant carried on the books; therefore permitting the co-operative to wear a cheap rouge of fiscal salubrity to mask a facial insolvency. Such a method of analysis is "exceptional," to say the least. It comes with small grace from one who defends his performance on the basis of an exceptional doctrine or procedure, to challenge the right of a class of investors to shift the burden of proving reliance to him because he admittedly *omitted* to tell *them* that his figures were "valid" only under a series of tenuous assumptions and by virtue of an exceptional procedure.

G. <u>The Rescissionary Remedy</u>

In determining whether rescission is a proper remedy in this case it would be well to keep in mind that we are dealing with debt securities – demand notes – rather than equity securities such as stocks. The rescissionary remedy which we contemplate will transfer notes from the class to Arthur Young & Co., who may then present them for payment to the trustee. Arthur Young will get the full *pro tanto* benefit of the class's settlement and allocation. In addition, Arthur Young will incidentally benefit from the

trustee's settlements and recoveries. In presenting the notes to the trustee, Arthur Young will participate in an estate which has been augmented by at least $3.4 million, and possibly more, once the estate takes possession of the allocated settlements and the Ball and Mourton judgment. Arthur Young will participate in the estate not as an equity shareholder would – behind the class of general creditors – but as a general creditor itself. One very substantial difficulty with the "out of pocket" measure of damages urged by Arthur Young & Co. is that to determine any individual recovery, one would have to construct *formulae* by which one could compute at any given instant the liquidation value of the Co-op when it issued the note. Since current ratio would be an important element in calculating the liquidation value of the Co-op, and since each note, withdrawal, and addition of interest would alter the current ratio, one can easily see that the evidentiary problem would be enormous. One should not lightly impose staggering computational burdens on an investor class, tying a court and jury up for weeks with mathematical *arcana* and multivariate regressions, on an issue for which the defense has chosen to offer no proof, theory of mitigation, or alternate solution. This is particularly the case where a procedure exists which not only greatly simplifies the jury's fact-finding task, but puts plaintiffs in the position they would have occupied if everyone had acted properly. *Speed v. Transamerica Corp.*, 135 F. Supp. 176 (D. Del. 1955).

Using this latter criterion, one concludes that, more than probably, if Arthur Young had "acted properly" and had issued an adverse opinion in 1982, the estate would have saved $2.0 million in further losses. Arthur Young

was found to have been half responsible for those losses, but of course not being preponderantly liable, was not answerable at all to the trustee in his suit. We do not quarrel with the law. We note, however, that one of the objections to the rescissionary remedy is that it permits one to recover for losses not exclusively or even partly caused by the fraud, but by market forces and conditions occurring after the sale. *Green v. Occidental Petroleum Corp.*, 541 F.2d 1335, 1342 (9th Cir. 1976). In this particular case, Arthur Young was found by the jury to have been half responsible for the Co-op's losses after April 22, 1982. Under an "out of pocket" measure of recovery, the class would fail to recover for subsequent declines, fully half of which were caused by Arthur Young. For the balance, they would have to apply to an estate which was depleted not in small part by Arthur Young's actions. As between a victim and the perpetrator, on whom should the loss fall? While there are good and substantial reasons why Arthur Young should be protected from damages arising from the trustee's suit, that rationale does not extend to parties, wholly innocent of blame, who were intentionally (or recklessly) misled to their ruin.

Finally, it bears remarking that the securities laws are bottomed in tort, not in contract. The conceptual difficulty to which Arthur Young alludes concerning the rescissionary remedy is one which proceeds from contract: *i.e.*, how can one "restore" that which he never received? The forms of action are dead, saith Maitland, but they truly rule us from the grave if they disable a court and jury from administering relief on a rational and efficient basis because "contract doctrine" holds that "specific restitution" cannot be ordered of one who has

not directly received property from the plaintiff, or who is not otherwise in privity with him.

Thus, in *Rolf v. Blythe, Eastman, Dillon & Co., Inc.*, *supra*, a BEDCO employee was held guilty of aiding and abetting the 10b-5 violation (largely because he recklessly failed to stop a fraud) of an independent investment advisor who churned and ravaged an investment account. Rescission was ordered against the BEDCO broker, and against BEDCO itself, even though the employee did not execute the transaction, recommend the security, or reassure the plaintiff with respect to the security. *Id.* at 49. Rescission was ordered, not because the particular defendant had possession of plaintiff's property, but because that measure of damages most nearly made the victim whole.

Loss, *Fundamentals of Securities Regulation* § 1183 (1983), notes:

> There is nothing basically incongruous about forcing a broker for either seller or buyer to assume ownership of securities for the first time. When rescission is based on contract theory – mistake or breach of contract – only the party to the contract is liable. But when it is based on fraud, privity is not essential. "To avoid unjust enrichment, general equitable principles indicate the preferability of the purchaser pursuing first the seller, rather than his partner in the fraud. However, as between the innocent purchaser and the wrongdoer who, though not a privy to the fraudulent contract, nonetheless induced the victim to make the purchase, equity requires the wrongdoer to restore the victim to

> the status quo." *Gordon v. Burr*, 506 F.2d 1080, 1085 (2d Cir. 1974).

(concerning section 12 liability).

The principle isolated by Loss is fully applicable here in a 10b-5 case. The goal of the securities laws is to *restore* the defrauded party to his *status quo ante* the purchase. The laws do not exist to give him a windfall. They do not indemnify his "expectations," or punish wrongdoers. Securities Exchange Act of 1934 § 28(a). Where a rescissionary remedy, as here, is plainly more appropriate in consideration of the plaintiff's loss, as well as in view of all the other facts and circumstances of the case, including the seriousness of the defendant's conduct, we are convinced that it should be chosen as the best and fairest method of restitution.

In summary, therefore, we find no merit in Arthur Young's contentions that the 10b-5 verdict should be set aside for lack of evidence or legal substantiation. Arthur Young has argued that the jury has unprecedentedly assigned liability to a secondary party for a failure to discover a fraud, and has argued that it owed no such duty to the broad class of investors. This case is, in a sense, unprecedented. On the charge under the Arkansas Securities Act, the jury found that Arthur Young essentially manufactured the misleading statements by means of which the demand notes were sold. We have to agree that this indeed is singular behavior. That circumstance, however, should not be one from which Arthur Young should take heart; rather it is a circumstance from which

it should take stock. The evidence fully justified the verdict against Arthur Young, and the "rescissionary" remedy we have applied. Furthermore, the circumstances of the case are such that prejudgment interest is appropriate, especially given the essentially liquidated nature of the demand. Upon entry of the judgment under 10b-5, plaintiffs may apply for attorneys' fees conformably with local rules (they will do so in any event as a result of the verdict under the state securities law) and the court will determine the propriety of any award under 10b-5, as well as the amount under either verdict.

/s/ H. Franklin Waters
United States
District Judge

Date: Feb. 5, 1987.

APPENDIX F

IN THE UNITED STATES DISTRICT COURT
WESTERN DISTRICT OF ARKANSAS
FORT SMITH DIVISION

THOMAS E. ROBERTSON, JR., as Trustee of the Farmer's Co-Op of Arkansas & Oklahoma, Inc.; BOB REVES; FRANCES GRAHAM; ROBERT H. GIBBS, individually; ROBERT H. GIBBS, as natural guardian of his minor children; THOMAS A. GIBBS and ROBERT H. GIBBS, JR.; and ROBERT H. GIBBS, JR., as Trustee of the Muskogee Internal Medicine Group Profit Sharing Funds PLAINTIFFS

v. Consolidated Cases No. 85-2044, 85-2096 85-2155 85-2259

JACK E. WHITE, ET AL. DEFENDANTS

JUDGMENT ORDER

[Filed February 5 1987]

This cause having been tried before this court and the jury having rendered its verdict, the court orders that judgment be entered as follows:

Definitions

1. Plaintiff *Thomas E. Robertson, Jr.,* ("Robertson") is the Trustee in Bankruptcy of the Farmer's Co-Op of Arkansas and Oklahoma, Inc. ("Co-Op").

2. The plaintiff *Class* is that group of individuals who purchased demand notes from the Co-Op between the dates of April 22,-1982, and February 23, 1984. Bob Reves, Frances Graham and Robert H. Gibbs are the Class representatives.

3. Defendant *Ball, Mourton & Adams* is a law partnership whose partners include E.J. Ball, Kenneth R. Mourton and Stephen E. Adams. It refers to and includes its predecessor firm, Ball & Mourton. A judgment against the partners and the partnership is effective against Stephen E. Adams only to the extent of his interest.

4. Defendant *Arthur Young* means Arthur Young & Company, four of whose partners at the times in question were defendants Harry C. Erwin, Billy Joe Cabaniss, Jr., Joseph F. Drozal, Jr., and Charles M. Hanson.

5. *Third party defendants* are Hall Brewer, Waldo Price, Truman O. Boatright, J.O. McClure, Hugh Winfrey, Jr., M.V. Creech, Charles Bane, E.H. Pritchett, Jr., Robert Plunkett, Ralph McClure, Jimmy Don Gooch, Jerry Metzger, W.J. Rimmer, Don Sebo, Joe Wayne Harris, James Willis, Dan Ray Core, Harold Davis, Jay Freeman, Jay Neal, Jr., George Wagnon, Raymond (Jack) Clark and Eddie Joe Smith.

JUDGMENT

Judgment shall be entered as follows:

1. As to Count III, alleging violations of the Arkansas and federal securities laws, a new trial is granted defendants Ball, Mourton & Adams, and E.J. Ball and Kenneth R. Mourton, unless the Trustee accepts,

within ten (10) days of the filing on this judgment, a remittitur on the verdict found by the jury in the sum of $982,000. If the Trustee accepts the remittitur, then judgment shall enter in the sum of $1,750,000 under both state and federal claims. The verdict and judgment under the state securities law shall bear prejudgment interest at the rate of six percent (6%), but no interest shall be collected on the federal law claim. The matter of fees and costs shall be taken up on motion after the filing of this judgment, in accordance with the opinion filed contemporaneously herewith. As a credit against the judgment amount, the defendants Ball, Mourton & Adams, and Ball and Mourton, shall be allowed the sum of either $2,692,000 on the state law claim or $1,030,656 on the federal law claim, conditional on the approval of settlements with the Trustee and the Class, now set for March 30-31, 1987. The court shall later set a schedule for plaintiffs to file a bill of costs and a petition to establish the amount of prejudgment interest and fees due. The Trustee shall be allowed the larger net recovery under this Count, after allowance of credits and establishment of interest, fees and costs.

2. As to Count VI, Arthur Young is ordered to pay to the Class $6,121,652.94, plus prejudgment interest, fees and costs, under both state and federal claims, subject to a credit in the amount of $5,600,000, conditional on settlements with the Class being approved. The judgment shall bear prejudgment interest and carry an award of fees under the state act, and prejudgment interest under the federal securities laws claims. Questions relating to the eligibility for fees under the federal claim, and the amount of any fees, shall be later determined. The court shall set a schedule for plaintiffs to file a bill of costs and

a petition to establish the amount of prejudgment interest and fees due. The Class shall be allowed the larger net recovery under this Count, after allowing credits and determining fees, interest and costs.

3. As to Count VII, judgment is entered for the Trustee against Ball, Mourton & Adams, and Ball and Mourton, in the amount of $51,980, plus costs, which shall be reduced in the sum of any unused credits given in paragraph 1.

4. Judgment is entered for defendants and against plaintiffs on Counts I, II, IV and XI.

5. Judgment is entered for third party defendants on all third party claims.

6. Judgment is entered for the plaintiffs on all counterclaims.

7. Pursuant to Rule 54b, the court finds that there is no just reason to delay enforcement of or appeal of this judgment.

IT IS SO ORDERED.

/s/ H. Franklin Waters
United States District Judge

Date: Feb. 5, 1987.

APPENDIX G

IN THE UNITED STATES DISTRICT COURT
WESTERN DISTRICT OF ARKANSAS
FORT SMITH DIVISION

THOMAS E. ROBERTSON, JR., as Trustee of the Farmer's Co-Op of Arkansas & Oklahoma, Inc.; BOB REVES; FRANCES GRAHAM; ROBERT H. GIBBS, individually; ROBERT H. GIBBS, as natural guardian of his minor children, THOMAS A. GIBBS and ROBERT H. GIBBS, JR.; and ROBERT H. GIBBS, as Trustee of the Muskogee Internal Medicine Group Profit Sharing Funds — PLAINTIFFS

v. Consolidated Cases No. 85-2044, 85-2096, 85-2155, 85-2259

JACK E. WHITE, ET AL. — DEFENDANTS

AMENDED JUDGMENT ORDER

[Filed April 27, 1987]

This cause having been tried before this court and the jury having rendered its verdict, the court orders that judgment be entered as follows:

Definitions

1. Plaintiff *Thomas E. Robertson, Jr.,* ("Robertson") is the Trustee in Bankruptcy of the Farmer's Co-Op of Arkansas and Oklahoma, Inc. ("Co-Op").

2. The plaintiff *Class* is that group of individuals who purchased demand notes from the Co-Op between the dates of April 22, 1982, and February 23, 1984. Bob Reves, Frances Graham and Robert H. Gibbs are the Class representatives.

3. Defendant *Ball, Mourton & Adams* is a law partnership whose partners include E.J. Ball, Kenneth R. Mourton and Stephen E. Adams. It refers to and includes its predecessor firm, Ball & Mourton. A judgment against the partners and the partnership is effective against Stephen E. Adams only to the extent of his interest.

4. Defendant *Arthur Young* means Arthur Young & Company, four of whose partners at the times in question were defendants Harry C. Erwin, Billy Joe Cabaniss, Jr., Joseph F. Drozal, Jr., and Charles M. Hanson.

5. *Third party defendants* are Hall Brewer, Waldo Price, Truman O. Boatright, J.O. McClure, Hugh Winfrey, Jr., M.V. Creech, Charles Bane, E.H. Pritchett, Jr., Robert Plunkett, Ralph McClure, Jimmy Don Gooch, Jerry Metzger, W.J. Rimmer, Don Sebo, Joe Wayne Harris, James Willis, Dan Ray Core, Harold Davis, Jay Freeman, Jay Neal, Jr., George Wagnon, Raymond (Jack) Clark and Eddie Joe Smith.

JUDGMENT

Judgment shall be entered as follows:

1. As to Count III, alleging violations of the Arkansas and federal securities laws, a new trial is granted defendants Ball, Mourton & Adams, and E.J. Ball and Kenneth R. Mourton, unless the Trustee accepts,

within ten (10) days of the filing on this judgment, a remittitur on the verdict found by the jury in the sum of $982,000. If the Trustee accepts the remittitur, then judgment shall enter in the sum of $1,750,000 under both state and federal claims. The verdict and judgment under the state securities law shall bear prejudgment interest at the rate of six percent (6%), but no interest shall be collected on the federal law claim. The matter of fees and costs shall be taken up on motion after the filing of this judgment, in accordance with the opinion filed contemporaneously herewith. As a credit against the judgment amount, the defendants Ball, Mourton & Adams, and Ball and Mourton, shall be allowed the sum of either $2,692,000 on the state law claim or $1,030,656 on the federal law claim, conditional on the approval of settlements with the Trustee and the Class, now set for March 30-31, 1987. The court shall later set a schedule for plaintiffs to file a bill of costs and a petition to establish the amount of prejudgment interest and fees due. The Trustee shall be allowed the larger net recovery under this Count, after allowance of credits and establishment of interest, fees and costs.

2. As to Count VI, Arthur Young is ordered to pay to the Class $6,121,652.94, plus prejudgment interest, attorney fees (only on the state securities claims) and costs, under both state and federal claims, subject to a credit in the amount of $5,744,780, conditional on settlements with the Class being approved. The judgment shall bear prejudgment interest and carry an award of fees under the state act, and prejudgment interest under the federal securities laws claims. Questions relating to the eligibility for fees under the federal claim, and the amount of any fees, shall be later determined. The court

shall set a schedule for plaintiffs to file a bill of costs and a petition to establish the amount of prejudgment interest and fees due. The Class shall be allowed the larger net recovery under this Count, after allowing credits and determining fees, interest and costs.

3. As to Count VII, judgment is entered for the Trustee against Ball, Mourton & Adams, and Ball and Mourton, in the amount of $51,980, plus costs, which shall be reduced in the sum of any unused credits given in paragraph 1.

4. Judgment is entered for defendants and against plaintiffs on Counts I, II, IV and XI.

5. Judgment is entered for third party defendants on all third party claims.

6. Judgment is entered for the plaintiffs on all counterclaims.

7. Pursuant to Rule 54b, the court finds that there is no just reason to delay enforcement of or appeal of this judgment.

IT IS SO ORDERED.

/s/ H. Franklin Waters
United States District Judge

Date: Apr. 23, 1987 .

APPENDIX H

IN THE UNITED STATES DISTRICT COURT
WESTERN DISTRICT OF ARKANSAS
FORT SMITH DIVISION

THOMAS E. ROBERTSON, JR., as Trustee of the Farmer's Co-Op of Arkansas & Oklahoma, Inc.; BOB REVES; FRANCES GRAHAM; ROBERT H. GIBBS, individually; ROBERT H. GIBBS, as natural guardian of his minor children, THOMAS A. GIBBS and ROBERT H. GIBBS, JR.; and ROBERT H. GIBBS, as Trustee of the Muskogee Internal Medicine Group Profit Sharing Funds — PLAINTIFFS

v. — Consolidated Cases No. 85-2044, 85-2096, 85-2155, 85-2259

JACK E. WHITE, ET AL. — DEFENDANTS

ORDER

[Filed April 27, 1987]

On this 23rd day of April, 1987, upon consideration of the post-judgment motions filed in the above captioned matter, the court finds as follows:

1. The motion of Arthur Young in support of its motion for judgment notwithstanding the verdict or, in the alternative, for a rehearing with respect to the issue of damages is denied.

2. The motion of Arthur Young to amend the judgment and to correct a clerical mistake is partially granted in that the judgment will be amended pursuant to Federal Rule of Civil Procedure 60(b) to correct a computational error in the calculation of the settlement credits and to reflect that attorneys' fees are not available under the federal securities law claims.

3. The plaintiffs' motion for amendment of judgment or, in the alternative, for reconsideration is denied.

IT IS SO ORDERED.

/s/ H. Franklin Waters
United States District Judge

APPENDIX I

United States Court of Appeals

FOR THE EIGHTH CIRCUIT

No. 87-1726/1727/1803/2533/88-1014WA

Arthur Young & Company,	*	Appeal from the United
Appellant,	*	States District Court for
	*	the Western District of
vs.	*	Arkansas
	*	
Bob Reves, et al.,	*	
Appellees.	*	

Appellant's petition for rehearing has been considered by the Court and is denied.

August 29, 1991

Order Entered at the Direction of the Court:

/s/ Michael E. Gens

Clerk, U.S. Court of Appeals, Eighth Circuit

APPENDIX J

STATUTORY PROVISIONS INVOLVED

Section 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. § 78j, provides in pertinent part:

> Sec. 10. It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or use of the mails . . .
>
> (b) To use or employ, in connection with the purchase or sale of any security . . . any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

Section 106 of the Arkansas Securities Act, Ark. Stat. Ann. § 23-42-106 provides in pertinent part:

> (a)(1) Any person who commits the following acts is liable to the person buying the security from him, who may sue either at law or in equity to recover the consideration paid for the security, together with interest at six percent (6%) per year from the date of payment, costs, and reasonable attorneys' fees, less the amount of any income received on the security, upon the tender of the security and any income received on it, or for damages if he no longer owns the security:
>
> (A) Offers or sells a security in violation of §§ 23-42-301, 23-42-212(b), or

23-42-501 or of any rule or order under § 23-42-502 which requires the affirmative approval of sales literature before it is used, or in violation of any condition imposed under §§ 23-42-403(d), 23-42-404(g), or 23-42-404(i); or

(B) Offers or sells a security by means of any untrue statement of a material fact or any omission to state a material fact necessary in order to make the statements made, in the light of circumstances under which they are made, not misleading, the buyer not knowing of the untruth or omission, and who does not sustain the burden of proof that he did not know, and in the exercise of reasonable care could not have known, of the untruth or omission;

(2) Damages are the amount that would be recoverable upon a tender less the value of the security when the buyer disposed of it and interest at six percent (6%) per year from the date of disposition.

(c) Every person who controls a seller liable under subsection (a) of this section or a purchaser liable under subsection (b) of this section; every partner, officer, or director of such a seller or purchaser; every person occupying a similar status or performing a similar function; every employee of such a seller or purchaser who materially aids in the sale; and every broker-dealer or agent who materially aids in the sale are also liable jointly and severally with, and to the same extent as, the seller or purchaser, unless the nonseller or nonpurchaser who is so liable sustains the burden of proof that he did not know, and in the exercise of

reasonable care could not have known, of the existence of the facts by reason of which the liability is alleged to exist. There is contribution as in cases of contract among the several persons so liable.